

No. 11417

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United States  
Circuit Court of Appeals  
For the Ninth Circuit.

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COMMISSIONER OF INTERNAL REVENUE,  
Petitioner,

vs.

NATIONAL RESERVE INSURANCE  
COMPANY,  
Respondent.

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Transcript of the Record

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Upon Petition to Review a Decision of the Tax Court  
of the United States

FILED

NOV 8 1918

PAUL P. O'BRIEN,  
CLERK



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Circuit Court of Appeals  
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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

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## APPEARANCES

For Taxpayer:

Z. SIMPSON COX, Esq.,

E. C. CROUTER, Esq.,

For Comm'r:

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Docket No. 112638

NATIONAL RESERVE INSURANCE COM-  
PANY, a Corporation,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent.

## DOCKET ENTRIES

1942

Oct. 1—Petition received and filed. Taxpayer notified. Fee paid.

Oct. 1—Copy of petition served on General Counsel.

Oct. 13—Notice of appearance of Z. Simpson Cox as counsel for taxpayer filed.

Nov. 4—Answer filed by General Counsel.

Nov. 4—Request for hearing in Los Angeles, Calif., filed by General Counsel.

Nov. 7—Notice issued placing proceeding on Los Angeles calendar. Service of answer and request made.

## 1943

- Aug. 10—Hearing set September 20, 1943—Los Angeles, California.
- Aug. 17—Motion to place on the Reserve calendar, filed by General Counsel.
- Aug. 19—Hearing set September 8, 1943 on motion.
- Aug. 30—Petitioner's joiner respondent's motion to place on Reserve calendar, filed.
- Sep. 1—Respondent's Motion of Aug. 17 granted to Reserve A.
- Sep. 5—Motion to place proceeding on Los Angeles, Calif. calendar filed by General Counsel. 9/7/44 Granted.
- Oct. 14—Hearing set November 27, 1944—Los Angeles, California.
- Nov. 27—Hearing had before Judge Arnold on & 28 merits. Briefs due 1/13/45, Replies 2/2/45. Statement of Amos A. Betts received in evidence with same force and effect as a deposition, filed at hearing.
- Dec. 21—Transcript of hearing 11/27/44 and 11/28/44 filed.

## 1945

- Jan. 11—Motion for extension to 1/31/45 to file opening briefs and 2/24/45 to file reply briefs, filed by General Counsel. 1/11/45 Granted.
- Jan. 30—Brief filed by General Counsel.
- Feb. 15—Motion for extension to 3/24/45 to file brief, filed by taxpayer. 2/16/45 Granted.



Mar. 23—Brief filed by taxpayer. Copy served.

Apr. 16—Reply brief filed by taxpayer. 4/16/45  
Copy served.

1946

Mar. 14—Findings of fact and opinion rendered.  
Judge Arnold. Decision will be entered  
for petitioner. 3/15/46 Copy served.

Mar. 15—Decision entered. Judge Arnold. Div. 12.

Jun. 3—Petition for review by U. S. Circuit Court  
of Appeals, 9th Circuit, with assignments  
of error filed by General Counsel.

Jun. 18—Proof of service of petition for review  
filed. (2) Counsel for taxpayer and tax-  
payer.

Jul. 16—Certified copy of an order from the 9th  
Circuit for extension to 8/12/46 to pre-  
pare and transmit the record, filed.

Aug. 2—Statement of points filed by General  
Counsel with statement of service thereon.

Aug. 2—Statement of evidence filed, with state-  
ment of service by mail thereon.

Aug. 2—Designation of portions of the record to  
be printed, filed by General Counsel, with  
statement of service by mail thereon.

Aug. 2—Designation of portions of record, pro-  
ceedings and evidence to be contained in  
the record on review, filed by General  
Counsel.

Aug. 6—Copy of an order from 9th Circuit ex-  
tending time to 9/12/46 to prepare and  
transmit the record filed.

United States Board of Tax Appeals

Docket No. 112638

NATIONAL RESERVE INSURANCE COM-  
PANY, a Corporation,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent.

## PETITION

Comes Now the above named petitioner and hereby petitions for a redetermination of the deficiency set forth by the Commisisoner of Internal Revenue in his notice of deficiency, LA:IT:90D:PB, dated July 7, 1942, and as a basis for its proceeding alleges as follows:

1. Petitioner is and was at all times herein mentioned an Arizona corporation duly qualified and doing business under and by virtue of the provisions of the Arizona Benefit Corporation Laws of 1937, (Art. 6, Chapt. 53, Arizona Code Annotated 1939), with principal office at 214 Phoenix National Bank Building, Phoenix, Arizona. The returns for the periods here involved were filed with the Collector for the District of Arizona. [3\*]

2. The determination of the Commissioner of Internal Revenue of petitioner's tax liability for the taxable years 1939 and 1940 and notice thereof,

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\* Page numbering appearing at top of page of original certified Transcript of Record.

a copy of which is attached hereto marked "Exhibit A", and by reference made a part hereof, was mailed to petitioner July 7, 1942.

3. The taxes in controversy are income taxes for the calendar years 1939 and 1940 in the amounts of \$1,087.59 and \$734.53, respectively.

4. The determination of the tax set forth in said notice of deficiency is based upon the following errors (no complaint being made as to any mathematical calculation):

(a) The Commissioner has determined: "It is determined that no part of your reserve funds is held for the fulfillment of life insurance contracts within the meaning of Section 201, Internal Revenue Code, and that you are subject to tax under the provisions of Section 207, Internal Revenue Code." Whereas, under the undisputed evidence before the Commissioner, and the law applicable thereunto, more than fifty per centum of petitioner's total reserve funds were held for the fulfillment of life insurance contracts within the meaning and intent of Section 201, Internal Revenue Code. [4]

(b) The Commissioner has failed to determine petitioner's income taxes for the years 1939 and 1940 under Sections 201, 202, and 203, Internal Revenue Code, but has erroneously determined same under section 207, Internal Revenue Code.

(c) The Commissioner has determined that the additions made to mortuary reserve during the taxable years 1939 and 1940 do not constitute addi-



tions required by law to be made within the respective years to reserve funds within the meaning of Section 207, Internal Revenue Code.

(d) The Commissioner has determined that the additions made to mortuary reserve during the taxable years 1939 and 1940 are not proper deductions in the computation of petitioner's taxable income under Section 207, Internal Revenue Code.

(e) The Commissioner has determined that the additions made by the petitioner to funds on deposit with the State of Arizona during the taxable years 1939 and 1940 do not constitute additions required by law to be made within the respective taxable years to reserve funds within the meaning of section 207, Internal Revenue Code.

(f) The Commissioner has determined that the additions made by petitioner to funds on deposit with the State of [5] Arizona during the taxable years 1939 and 1940 are not proper deductions in the computation of petitioner's taxable income under Section 207, Internal Revenue Code.

(g) The Commissioner has determined that petitioner is not an assessment insurance company within the purview of Section 207(c) (1) (A), Internal Revenue Code.

(h) The Commissioner has determined that the sums actually deposited with State Treasurer of the State of Arizona by petitioner in accordance with laws of the State of Arizona (Sec. 53-605 Arizona Code Annotated 1939) were not the net addi-



tions required by law to be made within the respective taxable years to reserve funds as provided in Section 207(c) (1) (A), Internal Revenue Code.

(i) The Commissioner has determined that the sums actually deposited by petitioner as an assessment insurance company with the State Treasurer of the State of Arizona pursuant to the law of the State of Arizona (Section 53-605 Arizona Code Annotated 1939 is not allowable as a deduction under section 207(c) (1) (A), Internal Revenue Code.

(j) The Commissioner has determined that petitioner's mortuary reserve funds as required by the laws of the State of Arizona (Section 53-606 and 53-609, Arizona [6] Code Annotated 1939 are not required by law within the meaning of Section 207 (c) (1) (A), Internal Revenue Code.

(k) The Commissioner has determined that petitioner's mortuary reserve funds (being premium deposits retained by petitioner for the payment of losses are not allowable as a deduction under Section 207(c) (3), Internal Revenue Code.

(l) The Commission has failed to properly classify petitioner under the Internal Revenue Code.

(m) The Commissioner has failed to properly determine petitioner's gross income under the Internal Revenue Code.

(n) The Commissioner has failed to allow petitioner deductions allowable under the Internal Revenue Code.

5. The facts upon which petitioner relies as a basis of this proceeding are as follows:

(a) The petitioner is and was at all times herein mentioned an insurance company engaged in the business of issuing life insurance contracts including contracts of combined life and accident insurance, and not engaged in any other business whatsoever, and the reserve funds of petitioner held for the fulfillment of such contracts have at all times herein mentioned comprised more than 50 per centum of its total reserve funds for all purposes. [7]

(b) The petitioner is a life insurance company as defined by and within the meaning of Section 201(a) Internal Revenue Code.

(c) The petitioner is not a mutual insurance company as defined by and within the meaning of Section 207 of the Internal Revenue Code.

(d) The Articles of Incorporation, By-laws and insurance contracts of petitioner require the setting aside of definite sums in a Mortuary Reserve Fund and its maintenance for the payment of claims arising under certificates of membership or policies issued upon the assessment plan, and in accordance with said Articles of Incorporation, By-laws and insurance contracts, petitioner set aside in said mortuary and reserve fund the net sum of \$6,557.65 in 1939 and \$4,762.98 in 1940.

(e) The mortuary reserve funds of petitioner are also required by the laws of the State of Arizona (Sections 53-606 and 53-609, Arizona Code Annotated 1939).

(f) The Corporation Commission (Insurance Department) of the State of Arizona by virtue of law also requires and makes mandatory the creation and maintenance of petitioner's mortuary reserve funds. [8]

(g) Petitioner deposited with the State Treasurer of the State of Arizona \$789.47 in 1940, under the provisions of the laws of the State of Arizona (Section 53-605, Arizona Code Annotated 1939), as additions to guarantee or reserve funds.

(h) The mortuary reserve funds of petitioner have been created from premium income of petitioner and from no other source.

(i) Petitioner's deposits with the State of Arizona have been created from premium income of petitioner and from no other source.

6. In the event this Honorable Board should determine that petitioner is taxable under Section 207, Internal Revenue Code, and only in that event, and without waiving petitioner's contention that it is a life insurance company taxable under Section 201, et seq., the further facts upon which petitioner also relies as a further basis for the proceeding are as follows:

(a) Petitioner is an assessment insurance company within the meaning of said Section 207(c) (1) (A), Internal Revenue Code.

(b) Petitioner has made actual deposits of the sum of \$789.47 in the calendar year 1940 with the State Treasurer of the State of Arizona under the



provisions of the law of the State of Arizona, (Section 53-605, Arizona Code Annotated, 1939) as additions to [9] guarantee or reserve funds.

(c) All additions to petitioner's mortuary reserve funds during the calendar years 1939 and 1940 were required by law to be made during each respective year to said reserve fund within the purview and meaning of Section 207(c) (1) (A), Internal Revenue Code.

(d) Petitioner required its members to make premium deposits to provide for losses and expenses.

(e) All amount retained by petitioner during the calendar years 1939 and 1940 were portions of premium deposits retained for the payment of losses or expenses.

(f) The increase in petitioner's deposits to the State of Arizona during the calendar year 1940 were portions of premium deposits by petitioner's members retained for the payment of losses or expenses.

(g) The increases in petitioner's mortuary reserve during the taxable years 1939 and 1940 were portions of premium deposits by petitioner's members retained for the payment of losses or expenses.

Wherefore, Petitioner Prays That This Board May Hear The Proceeding And Determine:

1. That petitioner is a life insurance company

as defined by and within the meaning of Section 201, Internal Revenue Code. [10]

2. That the mortuary reserve of petitioner is required by law as defined by and within the meaning of Section 202, Internal Revenue Code.

3. That the additions to deposits with the State Treasurer of the State of Arizona by petitioner are required by law as defined by and within the meaning of Section 202, Internal Revenue Code.

4. That from the gross income of petitioner as defined by Section 202, Internal Revenue Code, petitioner is entitled to allowable deductions as set forth in said section.

Petitioner Further Prays: That in the event this Honorable Board should determine that petitioner is not taxable under Section 201, Internal Revenue Code, but under Section 207 thereof, and only in that event, this Board will further determine:

1. That additions to petitioner's mortuary reserve in the calendar years 1939 and 1940 are allowable deductions from petitioner's gross income under section 207(c) (1) (A), Internal Revenue Code.

2. That additions to petitioner's deposits with the State Treasurer of the State of Arizona in the calendar year 1940 are allowable deductions from petitioner's gross income under Section 207(c) (1) (A), Internal Revenue Code.

3. That the amount of premium deposits re-

tained by petitioner in its mortuary reserve during the calendar years 1939 and 1940 is an allowable deduction from petitioner's gross [11] income under Section 207(c) (3), Internal Revenue Code.

4. That the amount of premium deposits retained by petitioner during the calendar years 1939 and 1940 for the payment of losses and expenses is an allowable deduction from petitioner's gross income under Section 207(c) (3), Internal Revenue Code.

Petitioner Further Prays: For such other and further relief as may be meet, just and proper in the premises, and your petitioner will ever pray.

Respectfully submitted,

NATIONAL RESERVE IN-  
SURANCE COMPANY,

By /s/ KENNETH K. POUND

Secretary-Treasurer.

Counsel:

J. Simpson Cox. [12]

State of Arizona,

County of Maricopa—ss.

Kenneth K. Pound, being by me first duly sworn, deposes and says:

That he is the Secretary-Treasurer of the National Reserve Insurance Company, a corporation, the petitioner in the foregoing petition, and that he is duly authorized to verify the foregoing petition and to make this affidavit thereto;

That he has read the foregoing petition and knows the contents thereof and that the same are true to the best of his knowledge, information and belief.

/s/ KENNETH K. POUND

Subscribed and sworn to before me this 29 day of September, 1942, at Phoenix, Maricopa County, Arizona.

[Seal] /s/ W. H. CHESTER

Notary Public.

My commission expires: Aug. 12, 1945. [13]

EXHIBIT "A"

Treasury Department  
Internal Revenue Service

12th Floor  
U. S. Post Office and Court House  
Los Angeles, California.

July 7, 1942

Office of Internal Revenue Agent in Charge Los Angeles Division LA:IT:90D:PB.

National Reserve Insurance Company,  
214 Phoenix National Bank Building,  
Phoenix, Arizona.

Sirs:

You are advised that the determination of your income tax liability for the taxable years 1939 and



1940 discloses a deficiency of \$1,822.12 as shown in the statement attached.

In accordance with provisions of existing internal revenue laws, notice is hereby given of the deficiency mentioned.

Within 90 days (not counting Sunday or a legal holiday in the District of Columbia as the 90th day) from the date of the mailing of this letter, you may file a petition with the United States Board of Tax Appeals for a redetermination of the deficiency.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Internal Revenue Agent in Charge, Los Angeles, California, for the attention of LA:Conf. The signing and filing of this form will expedite the closing of your returns by permitting an early assessment of the deficiency and will prevent the accumulation of interest, since the interest period terminates 30 days after filing the form, or on the date assessment is made, whichever is earlier.

Respectfully,

GUY T. HELVERING,

Commissioner.

Internal Revenue Agent in  
Charge.

Enclosures:

Statement.

Form of Waiver. [14]



STATEMENT

LA:IT:90D:PB

National Reserve Insurance Company,  
214 Phoenix National Bank Building,  
Phoenix, Arizona.

Tax Liability for the Taxable Years Ended  
December 31, 1939  
and  
December 31, 1940

Income Tax

Year	Liability	Assessed	Deficiency
1939	\$1,087.59	None	\$1,087.59
1940	734.53	None	734.53
	<hr/>	<hr/>	<hr/>
Total	\$1,822.12	None	\$1,822.12

In making this determination of your income tax liability, careful consideration has been given to the report of examination dated April 14, 1942.

It is determined that no part of your reserve funds is held for the fulfillment of life insurance contracts within the meaning of section 201, Internal Revenue Code, and that you are subject to tax under the provisions of Section 207, Internal Revenue Code.

The additions made during the taxable years to mortuary reserve and to funds on deposit with the State of Arizona do not constitute additions required by law to be made within the respective taxable years to reserve funds within the meaning of section 207, Internal Revenue Code, and are therefore not proper deductions in the computation of your taxable income under section 207, Internal Revenue Code.

—2—

National Reserve Insurance Company.

Statement.

## ADJUSTMENT TO NET INCOME

Taxable Year Ended December 31, 1939

Net income (loss) as disclosed by return..... (\$ 21.18)

Addition to net income:

Adjustment resulting from the determination of net income as shown below .....	6,612.65
---	----------

Net income adjusted .....	\$6,591.47
---------------------------	------------

## EXPLANATION OF ADJUSTMENT

Giving effect to the above holdings with respect to the additions to the mortuary reserve and to funds on deposit with the State of Arizona, your net income for this taxable year has been determined under the provisions of section 207, Internal Revenue Code, as follows:

Income:

Premium Income .....	\$24,395.22
Membership fees .....	5,453.00

Total income .....	\$29,848.22
--------------------	-------------

Expenses:

Claims paid .....	\$ 3,723.91
Claims expense .....	104.13
Refunds to members .....	1,597.93
Salaries .....	4,463.30
Printing & Stationery .....	212.00
Office supplies .....	173.08
Postage .....	631.36
Rent .....	645.29
Directors fees .....	180.00
Bond premiums .....	27.00
Legal & audit .....	105.12
Medical fees .....	32.00
Taxes .....	41.24
Miscellaneous .....	128.66
Commissions and fees paid .....	10,696.56
Reinstatements & hospitalization fund .....	495.17

Total expenses .....	\$23,256.75
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Net income .....	\$ 6,591.47
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—3—

National Reserve Insurance Company.

Statement.

## COMPUTATION OF INCOME TAX

Taxable Year Ended December 31, 1939

Net income adjusted .....	\$ 6,591.47
Special class net income .....	\$ 6,591.47
Income tax:	
16½% of \$6,591.47 .....	\$ 1,087.59
Income tax assessed .....	None
Deficiency of income tax .....	\$ 1,087.59

## ADJUSTMENT TO NET INCOME

Taxable Year Ended December 31, 1940

Net income (loss) as disclosed by return.....	(\$ 5.80)
Addition to net income:	
Adjustment resulting from the determination of net income as shown below.....	4,952.08
Net income adjusted .....	\$ 4,946.28

## EXPLANATION OF ADJUSTMENTS

Giving effect to the above holdings with respect to the additions to the mortuary reserve and to funds on deposit with the State of Arizona, your net income for this taxable year has been determined under the provisions of section 207, Internal Revenue Code, as follows:

Income:	
Premium income .....	\$30,238.41
Membership fees .....	11,690.44
Reinstatement fees .....	477.60
Other income .....	206.92
Less: Payments refunded .....	(37.58)
Total income .....	\$42,575.79

—4—

National Reserve Insurance Company.

Statement.

## Expenses:

Claims paid .....	\$ 5,256.20
Claims expense .....	436.45
Refunds to members .....	4,154.18
Salaries .....	5,617.50
Printing & stationery .....	500.69
Office Supplies .....	194.35
Postage .....	856.80
Rent .....	640.79
Directors fees .....	175.00
Bond premiums .....	27.00
Legal & audit .....	25.00
Medical fees .....	43.00
Taxes .....	57.05
Miscellaneous .....	161.26
Commissions and fees paid .....	19,242.68
Reinstatement & hospitalization fund .....	241.56
<hr/>	
Total expenses .....	\$37,629.51
Net income .....	\$ 4,946.28

## COMPUTATION OF INCOME TAX

Taxable Year Ended December 31, 1940

Net income adjusted .....	\$ 4,946.28
Normal-tax net income .....	4,946.28
Income tax:	
13½% of \$4,946.28 .....	\$667.75
Defense tax (10% of \$667.75) .....	66.78
<hr/>	
	\$ 734.53
Income tax assessed: .....	None
<hr/>	
Deficiency of income tax .....	\$ 734.53

[Endorsed]: U. S. Board of Tax Appeals. Filed Oct. 1, 1942.



The Tax Court of the United States

Docket No. 112638

NATIONAL RESERVE INSURANCE COM-  
PANY, a Corporation,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent.

### ANSWER

Comes Now the Commissioner of Internal Revenue, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and for answer to the petition of the above-named taxpayer, admits and denies as follows:

1 and 2. Admits the allegations contained in paragraphs 1 and 2 of the petition.

3. Admits that the taxes in controversy are income taxes for the calendar years 1939 and 1940, but denies the remainder of paragraph 3 of the petition.

4 (a) to (n), inclusive. Denies the allegations of error contained in subdivisions (a) to (n), inclusive, of paragraph 4 of the petition.

5 (a) to (i), inclusive. Denies the allegations contained in subdivisions (a) to (i), inclusive, of paragraph 5 of the petition.

6 (a) to (g), inclusive. Denies the allegations

contained in subdivisions (a) to (g), inclusive, of paragraph 6 of the petition. [19]

7. Denies each and every allegation contained in the petition not hereinbefore specifically admitted or denied.

Wherefore, it is prayed that the determination of the Commissioner be approved.

/s/ J. P. WENCHEL

Chief Counsel,

Bureau of Internal Revenue.

Of Counsel:

ALVA O. BAIRD

Division Counsel.

FRANK T. HORNER,

SAMUEL TAYLOR,

Special Attorneys,

Bureau of Internal Revenue.

st-ppw 10-30-42

[Endorsed]: T.C.U.S. Received and filed Nov. 4, 1942. [20]

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[Title of Tax Court and Cause.]

6 T. C. No. 61

Promulgated March 14, 1946.

FINDINGS OF FACT, OPINION AND  
DISSENTING OPINION

During 1939 and 1940 petitioner was engaged in writing life insurance contracts. Its mortality or

reserve fund for the protection of its policyholders was maintained in compliance with its by-laws and insurance contracts and exceeded the reserves required by Arizona law. Petitioner erroneously charged on its books certain minor expense items to its mortality fund during each of the taxable years. It charged refunds to policyholders and expenses incident to settlement of policy claims against the mortality fund as authorized by Arizona law. None of the charges so made impaired the reserves required by state law. Held: petitioner is a life insurance company within the meaning of section 201 (a) I.R.C., as the reserve funds held for the purpose of fulfilling its life insurance contracts were in excess of 50 percent of its total reserve funds.

Z. SIMPSON COX, Esq.,  
for the petitioner.

EARL C. CROUTER, Esq.,  
for the respondent. [21]

The Commissioner determined deficiencies in income taxes for 1939 and 1940 in the respective amounts of \$1,087.59 and \$734.53. He held that no part of petitioner's reserve funds was held for the fulfillment of life insurance contracts within the meaning of section 201, Internal Revenue Code, and that petitioner was subject to tax under section 207 of the Code. In computing petitioner's tax liability under section 207 he held that additions to petitioner's "mortuary reserve and to funds on deposit with the State of Arizona do not consti-



tute additions required by law to be made within the respective taxable years to reserve funds within the meaning of section 207, Internal Revenue Code, and are, therefore not proper deductions in the computation of your taxable income under section 207, Internal Revenue Code.” Petitioner challenges these determinations by respondent.

### FINDINGS OF FACT

Petitioner is an Arizona corporation doing business under and by virtue of the provisions of the Arizona Benefit Corporation Laws of 1937, Art. 6, Chap. 53, Arizona Code Annotated, 1939. Its principal office is at Phoenix, Arizona. Its tax returns for 1939 and 1940 were filed with the collector for the district of Arizona.

For 1939 petitioner reported on its income and excess profits tax return total income of \$14,296.25, deductions of \$14,317.43, and a net loss of \$21.18. The return stated that petitioner was engaged in the “Assessment Insurance” business and that it was a non-stock, non-profit, mutual corporation. For 1940 petitioner reported total income of \$22,909.82, deductions of \$22,915.62, and a net loss of \$5.80. This return stated that it was engaged in the life insurance business and was a non-stock, non-profit, mutual corporation. [22]

During the taxable years petitioner issued only two types of life insurance policies, known as the “Individual or Group Life Policy” and the “Whole Life Insurance Policy.” The Individual or Group



Life Policies provided with respect to the "Reserve or Mortality Fund" that—"After the first month 25% of the first year's premium and 66-2/3% of all subsequent payments, will be placed in this Fund, for the purpose of payment of claims and expenses incidental thereto." The Whole Life Insurance Policies carried the same provisions with respect to the Reserve or Mortality Fund except that after the first month 50% of the first year's premium and 66-2/3% of all subsequent payments were to be placed in the reserve or mortality fund. All life insurance policies issued prior to the taxable years carried the same provision as the Whole Life Insurance Policy except one which specifically incorporated the provisions of petitioner's by-laws into the certificate or policy.

Petitioner's by-law with respect to the reserve or mortality fund provided as follows:

#### Article XVI.

##### Funds

Section 1. The Death Benefit Fund of this Association shall be created, maintained and shall consist of Fifty per cent (50%) of the first year's assessment, less the first month's payment; and sixty-six and two-thirds per cent (66-2/3%) of all subsequent payments except where a certificate shall lapse and reinstatement shall be dispersed in the same manner as the first year's assessment following the date of issuance of the certificate. The money in the Death Benefit Fund shall be used for the payment of death losses, however, the Board of

Directors may set aside a portion of the savings in said fund for the purpose of organizing a legal reserve life insurance company, and shall issue in January of every year beginning January 1936 a certificate of evidence to each member of the Association who has paid twelve consecutive monthly payments without lapsing, showing his or her pro rata in such savings. [23]

Section 2. The expense fund of this Association shall be created, maintained and shall consist of only, the membership and registration fees, the first month's payment of assessment and the first month's payment of any reinstatement, and fifty per cent (50%) of the following eleven months' payments and thirty-three and one-third per cent ( $33\frac{1}{3}\%$ ) of all subsequent payments.

The Arizona Benefit Corporation Law of 1937 required that every benefit certificate issued by any such corporation shall specify the maximum amount not exceeding \$5,000, on the life of any individual, to be paid on the happening of the contingency therein stated, and "shall state the basis or amount to be set aside to the mortuary and reserve fund." Arizona Code, 1939, sec. 53-606. Every benefit corporation was required to provide in its benefit certificate for periodical payments or dues sufficient "to pay benefit claims and general operating expenses as stipulated therein." Sec. 53-609 (a), and sub-paragraph (b) of said section provided as follows:

(b) A mortuary and reserve fund, exclusive of

other assets, may be created, out of which may be paid all benefit claims arising under the certificates, the deposits required to be made with the state treasurer as provided by section 608b, and attorney's fees and necessary expense arising out of the defense, settlement, or payment of any contested or disputed claim. The residue of payments made by members, after setting aside the amount required for the mortuary and reserve fund, and interest earned by the assets of the corporation, whether deposited with the state treasurer or otherwise invested, may be used for general operating expenses.

Section 53-610 provided that the state Corporation Commission should require the examination and audit of the books and affairs of each benefit corporation at least once in every two years by an accountant designated and commissioned by it for the purpose of verifying the funds as provided in the benefit certificate. The cost of any such examination and audit was to be paid by the benefit corporation but it was not required to pay for more than one examination and audit in any one year, and not to exceed \$25 for each 1,000 certificates or fraction thereof in force at the time of the examination. Section 53-611 required the benefit [24] corporation to file a copy of its certificate with the Corporation Commission before soliciting business thereon and the Commission was required within three days to issue a certificate of authority to transact business thereon if the certificate con-



formed to the requirements of the Benefit Corporation law.

The Corporation Commission submitted the copy filed with it pursuant to sec. 53-611 to its actuary to ascertain whether the provisions thereof met all the requirements of law and its rules and regulations, with respect to the reserve fund set up for the protection of policyholders. Except for the first year the Commission required any new insurance policy to provide for the placing of not less than 50 percent of the premiums in a reserve fund, which amount was deemed sufficient to enable the reserve fund to meet all the requirements of the American Standard Mortality Table on the basis of  $3\frac{1}{2}$  percent interest accretions. Each year since 1937 petitioner has been examined by and has met the requirements of the Arizona Corporation Commission.

Petitioner's mortality fund for the taxable years shows the following allocations to and disbursements from the fund:

#### MORTUARY FUND

Balance in Reserve January		
1, 1939 .....		\$8,095.46
Gross Amount allocated to		
Fund, Year 1939 .....	11,960.08	
Paid out for Death Claims 3,828.04		
Paid out Refunds to Policy-		
holders .....	1,597.93	5,425.97
	<hr/>	<hr/>
Balance of 1939 allocation un-		
expended .....		6,564.11
		<hr/>

Total Reserve Fund		
December 31st .....		14,659.57
Gross Amount allocated to		
Fund, 1940 .....	14,514.16	
Paid out for Claims .....	5,437.60	
Paid out Refunds to Policy-		
holders .....	4,154.18	9,591.78
	<hr/>	<hr/>
Balance 1940 allocation un-		
expended .....	4,922.38	
Less allocation to fund		
on hospitalization in		
error, based on State		
Examination, January		
14, 1941 .....	241.56	4,680.82
	<hr/>	<hr/>
Total Reserve Fund December		
31, 1940 .....		\$19,340.39

The cash and other assets held in reserve for claim purposes as of the end of 1939 and 1940 consisted of cash on hand or in bank \$8,257.75 and \$11,248.26, respectively, deposit with state treasurer \$2,000 and \$2,789.47, respectively, secured loans of \$337.16 and \$349.92, respectively, and government bonds of \$5,015.58 for each year. Petitioner's actual assets held in reserve for claim purposes exceeded the total reserve fund shown at the end of the taxable years in its mortality fund.

Petitioner's general ledger carried an account entitled, "Income - Premium Renewals - Mortality Fund." Petitioner charged this account with payments on policy claims, expenses incidental thereto, refunds to policy holders, and certain minor items hereinafter considered. The petitioner was required by the state Corporation Commission to make

refunds to policy holders under the provisions of by-law XVI relating to the savings in its Death Benefit or Mortality Funds. Such Refunds, shown as "Paid out Refunds to Policyholders" in the preceding table, were reflected in its general ledger account as "dividends". Petitioner's mortality fund or reserve after refunding the savings to policyholders was in excess of the reserve required by the Commission to protect policyholders. The expenses incidental to payment of policy claims included telephone, telegraph and hospital bills, medical, notary and attorney fees, and traveling expenses, all of which charges were tied in with specific policy claims settled by the petitioner. The expenses incidental to settling a policy claim were not excessive nor were the aggregate incidental expenses excessive for either of the taxable years. The minor items charged to the account aggregated \$34.99 in 1939 and \$47.03 in 1940. These minor disbursements were not identified with any specific claim and were erroneously charged on petitioner's books against its mortality fund. For 1939 these minor items were: "State audit", \$25.00; telegram, 32 cents; check book, \$1.00; bank service charge, \$2.10; N. S. F. ck., \$1.32; correction, \$5.25. For 1940 these minor items were: "State audit", \$25.00; N. G. check, \$4.13; bank service charges, \$2.79. \$7.48 and \$7.63. Petitioner credited the account with the total monthly receipts allocated to the mortality fund and balanced the account monthly.

Except for \$206.92 received in 1940 as income from invested funds, petitioner's income during the



taxable years was derived entirely from premiums. Each premium payment was allocated daily to the mortality fund and the expense fund in accordance with the terms of the life insurance contract.

During the taxable years petitioner maintained the reserves required by the laws of Arizona and its policy contracts. More than 50 percent of its total reserve funds were held for the fulfillment of its life insurance contracts, and petitioner is entitled to classification as a life insurance company within the meaning of section 201, Internal Revenue Code, and applicable Treasury regulations.

### OPINION

Arnold, Judge: The question of whether a corporation operating under the Arizona Benefit Corporation Laws of 1937 is entitled to classification as a life insurance company for Federal income tax purposes was considered by this Court in *Reliance Benefit Association, a Corporation*, 2 T. C. 15, petition to review dismissed, June 13, 1944, 143 Fed. (2d) 597. We there construed sections 201 (a) of the Revenue Acts of 1936 and 1938, the provisions of which are identical with the provisions of section 201 (a), Internal Revenue Code, set forth in the margin,<sup>1</sup> and held the taxpayer was a life insurance company as defined by the Federal revenue statutes.

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<sup>1</sup>Sec. 201. Tax on Life Insurance Companies.

(a) Definition.—When used in this chapter the term life insurance company means an insurance company engaged in the business of issuing life insurance and annuity contracts (including contracts

Petitioner relies upon our decision in the cited case, and contends that the evidence adduced establishes its right to be similarly treated. It is conceded that there is a deficiency if the reserves maintained by petitioner are not reserves "required by law", and if petitioner falls under section 207, I.R.C., which relates to mutual insurance companies other than life.

The taxing statute defines a life insurance company as an insurance company engaged in issuing life insurance, the reserve funds of which held for the fulfillment of such contracts comprise more than 50 per centum of its total reserve funds. The facts show that petitioner was engaged during the taxable years in issuing life insurance policies. Its "total reserve funds" within the meaning of section 201 (a) *supra*, must, therefore, relate to reserves set up in connection with its life insurance business.

To be entitled to classification as a life insurance company under section 201 (a) the evidence must show that petitioner's reserves held for the fulfillment of its life insurance contracts comprised more than 50 per centum of its total reserve funds. The facts show that the Arizona law and the Commission charged with the enforcement of the law, whose rules and regulations had the force and effect of the law,<sup>2</sup> and under which petitioner operated, required

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of combined life, health, and accident insurance), the reserve funds of which held for the fulfillment of such contracts comprise more than 50 per centum of its total reserve funds.

<sup>2</sup>Reliance Benefit Association, *supra*, pp. 16-17.



petitioner to place 50 percent of its premium receipts, after the first year, in a reserve fund which, with interest accretions at  $3\frac{1}{2}$  percent, was deemed sufficient under recognized mortality tables to protect policyholders.

All policy forms issued by petitioner during the taxable years were examined by the state commission and were approved as meeting state legal requirements for the protection of policyholders. Our findings show that petitioner allocated daily to its mortality reserve fund  $66\frac{2}{3}$  percent of its premium receipts, after the first year, as required by the provisions of its life insurance policies. The facts show that each year since 1937 petitioner has been examined by the Arizona Corporation Commission and found to meet state requirements relative to the maintenance of reserves. It is clear that without compliance with state requirements petitioner would have been forced to cease doing business. *Pioneer Mutual Benefit Association v. Corporation Commission*, 123 Pac. (2d) 828.

In the transaction of its life insurance business petitioner maintained only two funds, namely, its mortality fund and its expense fund. The mortality fund was the reserve fund held by petitioner for the fulfillment of its life insurance contracts. The expense fund was used to meet the general operating expenses of the business and certainly was not a reserve within the meaning of that term as defined by the Supreme Court in *Maryland Casualty Company v. United States*, 251 U. S. 342, 350, which

definition is the basis for the definition appearing in the Treasury's regulations.

Respondent introduced as an exhibit petitioner's general ledger account for the taxable years for the purpose of showing that certain items charged against the mortality fund were not strictly benefit claims. The largest such items charged to this account during the taxable years were refunds to policyholders or dividends. Such disbursements were in no proper sense a part [29] of petitioner's operating costs or expenses. They recorded the pro rata refund to petitioner's policyholders of excess premiums. Petitioner was a non-stock, non-profit, mutual corporation and the savings or excess premiums in its mortality fund belonged to its policyholders. Its mortality reserve was not impaired by the pro rata distributions to policy holders. At all times material hereto this reserve was in excess of legal requirements. The incidental expenses charged to the mortality reserve were properly charged thereto under state law and petitioner's by-law XVI. The ledger entries with respect to incidental expenses specifically referred to the policyholder whose claim was being settled and the expense items charged to the fund were incidental to settlement of the claims payable under the policies. The aggregate amount in each year was not excessive and did not impair the reserve fund required by law to protect its policyholders. The minor items were frankly admitted by petitioner to be an improper charge against the mortality fund. It is urged, however, that these items were nominal in

amount, and did not affect the sufficiency of petitioner's reserve, and show that the ledger account was not kept in accordance with good bookkeeping practices.

Respondent argues strenuously that because of these charges the reserve funds held by petitioner were not true reserves as defined by section 201 (a), since the reserve fund was subject to and was actually used to meet general operating expenses as well as policy claims. Respondent cites and relies upon *First National Benefit Society v. Stuart*, (CCA-9, 1943) 134 Fed. (2d) 438, 30 AFTR 1151, certiorari denied, 320 U. S. 211; *First National Benefit Society v. Stuart*, (D.C. 1944) unreported case, decided June 15, 1944, 444 CCH 19440, and section [30] 19.203 (a) (2)-1 of Treasury Regulations 103.<sup>3</sup> We do not understand that respondent

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<sup>3</sup>Sec. 19.203 (a) (2)—1. Reserve Funds.—In general, the reserve contemplated is a sum of money, variously computed or estimated, which, with accretions from interest, is set aside (reserved) as a fund with which to mature or liquidate, either by payment or reinsurance with other companies, future unaccrued and contingent claims. It must be required either by express statutory provisions or by rules and regulations of the insurance department of a State, Territory or the District of Columbia when promulgated in the exercise of a power conferred by statute, but such requirement, without more, is not conclusive; for example, it does not include reserves required to be maintained to provide for the ordinary running expenses of a business definite in amount, and which must be currently paid by every company from its income if its business is to continue, such as taxes, salaries, reinsurance and unpaid brokerage; the reserve or



denies the sufficiency in amount of petitioner's mortality reserve; his point is that regardless of the amount set aside in the fund it was not a reserve since it could be and was invaded for ordinary operating expenses, and if a part of the fund is subject to such use the entire fund could be so used, which prevents the fund from being a "reserve fund" within the meaning of section 201 (a) *supra*.

In considering respondent's argument it must be remembered that general operating expenses were payable out of the expense fund provided for by section 2, Art. XVI of petitioner's by-laws. His argument poses the question of whether the payment of minor items, which in no way impaired the reserve funds required for the protection of policyholders, and which were erroneously charged thereto, makes that reserve fund other than a reserve for benefit claims. We think not. To so hold would give book entries a probative weight to which such entries are not entitled, *Doyle v. Michell Bros. Co.* 247 U. S. 179, 3 AFTR 2979. Petitioner's assets available to satisfy policy claims and the mortality reserve exceeded [31] mortality reserve requirements. Bookkeeping errors or the use of this excess for business purposes should not defeat petitioner's

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net value of risks reinsured in other solvent companies to the extent of the reinsurance; reserve for premiums paid in advance; annual and deferred dividends; accrued but unsettled policy claims; losses incurred but unreported; liability on supplementary contracts not involving life contingencies; estimated value of future premiums which have been waived on policies after proof of total and permanent disability.



classification as a life insurance company where it otherwise meets the requirements of section 201.

Respondent argues that we should construe the term "reserve funds" in section 201 (a) the same as the Treasury Regulations construe that term in section 203 (a) (2) of the Code. In *Reliance Benefit Association*, *supra*, we assumed that the term "reserve funds" was to be given the same meaning in both sections. On that point, among other things, we said: "The validity of such regulations (referring to the regulations on this point) has been recognized by this and other courts, *Swift and Co. Employees Benefit Association*, 47 B. T. A. 1011 and cases cited therein \* \* \*."

But while agreeing with the Commissioner in the *Reliance Benefit Association* case, *supra*, that the term "reserve funds" meant the same in both sections of the statute, we did not agree with him that the reserves there involved did not meet the test of the statute. We held that "reserve funds" in that case, which were arrived at in all essential respects in the same way as in the instant case, qualified as true life insurance reserves within the purview of section 201 (a), and that the taxpayer there was taxable as a life insurance company. We so hold here. [32]

The *First National Benefit Society* cases cited by respondent, *supra*, are factually distinguishable. The Circuit Court decision dealt with the Arizona laws prior to the 1937 revision and amendments. The court there agreed with the lower court's find-

ing that the First National Benefit Society did not voluntarily keep, and no statute, rules, or regulations of the state or governing body required the Society to keep, a reserve fund for the fulfillment of its life insurance contracts. Here, the Arizona law as interpreted by its Supreme Court in Pioneer Mutual Benefit Association, *supra*, not only required the creation of the reserve fund but delegated to the Arizona Corporation Commission the power and duty to require that the reserve so established shall be sufficient to pay benefit claims under the policies. Reliance Benefit Association, *supra*, pp. 16 and 17. The District Court decision in the First National Benefit Society case, *supra*, decided June 15, 1944, dealt with 1938 taxes and affirmed Articles 201 (a)-1 and 203 (a)-1 of Treasury Regulations 101 in their interpretation of section 201 (a) of the Revenue Act of 1938. The District Court read into the term "reserve funds" in section 201 (a), the same meaning given the term in section 203 (Art. 203 (a)-1, Reg. 101) by concluding as a matter of law that the Society did not have or maintain a "reserve fund" for the sole purpose of fulfilling its insurance contracts. Since the filing of briefs herein the Circuit Court of Appeals for the Ninth Circuit has affirmed the District Court in *First National Benefit Society v. Stuart*, ..... Fed. (2d) ....., (December 11, 1945) not upon the above ground, but upon the ground that petitioner had failed to sustain its burden of proof, i. e., that it was a life insurance company within the meaning of section 201. We can find no such

failure of proof in the instant case, which also differs in other [33] material respects from the District Court case.

As hereinbefore indicated we are of the opinion that this petitioner was required to and did maintain reserves for the fulfillment of its life insurance contracts. These reserves were in excess of 50 percent of petitioner's total reserve funds. Except for certain minor charges against the mortality reserve, which did not change the character of that reserve, our facts are comparable to the facts in *Reliance Benefit Association*, *supra*. Since the petitioner wrote only life insurance contracts and since its reserves held to fulfill such contract obligations were in excess of 50 percent of its total reserve funds, we hold that petitioner is a life insurance company within the meaning of section 201 of the Code, and that there is no deficiency for either of the taxable years.

Reviewed by the Court.

Decision will be entered for the petitioner. [34]

Disney, J., dissenting:

The reserve in question in this case must be one "held for the fulfillment of" life insurance and annuity contracts. As I read the record in this matter, the reserve can not be said to be so here. The prime object of life insurance, I take it, is the safety of the policy holders. Therefore, reserves "for the fulfillment of such contracts" are required by section 201 (a). In my view, considering the object of life insurance to be as above seen,



the reserve must be one exclusively held for the fulfillment of the life insurance contracts. I think the word "exclusively," although not expressed in the text of the Act, is, because of the nature of the legislation, a reasonable interpretation. The mortuary fund here, however, was held not solely for the fulfillment of the insurance policies, but for the paying of premium refunds, attorney's fees, for the setting up of a legal reserve life insurance company, and for other expenses. Moreover, on the matter of premium refunds, it appears that any excessive premiums were returnable from the mortuary fund—although only 25 per cent or 50 per cent of the premiums of the first year of a policy, and  $66\frac{2}{3}$  per cent of the premiums in later years, went into the reserve, thus subjecting the reserve to a drain of a greater amount than ever went into it. As to attorney's fees, not only was there no limit to the cost of litigation which might be taken from the fund under this item, but the expenses of attorney's fees to contest insurance policies appears to me to be the antithesis of the "fulfillment of such contracts"—for which reserve funds must be held. I am altogether unable to [35] comprehend how a mortuary fund, subject to be drawn upon to set up a legal reserve life insurance company can be said to be held for the fulfillment of the insurance contracts.

In my opinion, therefore, the mortuary fund here involved was held also for the payment of premium refunds, attorney' fees, and formation of a legal reserve life insurance company, and therefore not



“for the fulfillment” of life insurance and annuity contracts. I would not say that mere mistaken charges against the mortuary fund, due to error, would violate the statute, but any withdrawals except by such error, indicate that the fund was held for the purposes of such withdrawals, and not merely for the fulfillment of life insurance policies.

The present question was not discussed or decided in *Reliance Benefit Association, a Corporation*, 2 T. C. 15, so that if it in fact lurked in the record in that case, the opinion is not authority here. It involved only the manner of computing a reserve, and not whether it could be drawn upon for various and sundry matters aside from fulfillment of the contracts and still be within section 201 (a). I therefore dissent.

Hill, J., agrees with this dissent.

[Seal] T. C. V. S. [36]

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[Title of Tax Court and Cause.]

### DECISION

Pursuant to the determination of the Court, as set forth in its Findings of Fact and Opinion, promulgated March 14, 1946, it is

Ordered and Decided: That there are no deficiencies in income tax for the years 1939 and 1940.

[Seal] /s/ WILLIAM W. ARNOLD,  
Judge.

[Entered]: V. S. T. C. March 15, 1946. [27]

In the United States Circuit Court of Appeals  
for the Ninth Circuit

B.T.A. Docket No. 112638

COMMISSIONER OF INTERNAL REVENUE,  
Petitioner on Review,

vs.

NATIONAL RESERVE INSURANCE COM-  
PANY,

Respondent on Review.

### PETITION FOR REVIEW

The Commissioner of Internal Revenue, hereinafter referred to as the Commissioner, holding his office by virtue of the laws of the United States, hereby petitions the United States Circuit Court of Appeals for the Ninth Circuit to review the decision entered by The Tax Court of the United States on March 15, 1946, ordering and deciding that there are no deficiencies in income tax due from the National Reserve Insurance Company for the calendar years 1939 and 1940. This petition for review is filed pursuant to the provisions of Sections 1141 and 1142 of the Internal Revenue Code.

National Reserve Insurance Company, the respondent on review, hereinafter referred to as the taxpayer, is an Arizona corporation duly qualified and doing business under and by virtue of the provisions of the Arizona Benefit Corporation Laws of 1937 (Art. 6, Chap. 53, Arizona Code Annotated,

1939), and filed its corporation income, declared value excess-profits, and defense tax returns (Form 1120) for the years 1939 and 1940 with the Collector of Internal Revenue for the District of Arizona at Phoenix, Arizona, whose office is within the jurisdiction of the United States Circuit Court of Appeals for the Ninth Circuit, wherein this review is sought. [38]

### NATURE OF CONTROVERSY

The nature of the controversy is as follows:

During the years 1939 and 1940, the taxpayer, an insurance company, was engaged in issuing policies known as the "Individual or Group Life Policy" and the "Whole Life Insurance Policy" in the State of Arizona. The Arizona Benefit Corporation Law of 1937 required that every benefit certificate issued by any such corporation shall specify the maximum amount, not exceeding \$5,000, on the life of any individual to be paid on the happening of the contingency therein stated, and "shall state the basis or amount to be set aside to the mortuary and reserve fund." The individual or group life policies provided with respect to the "Reserve or Mortality Fund" that "After the first month 25% of the first year's premium and 66-2/3% of all subsequent payments, will be placed in this Fund, for the purpose of payment of claims and expenses incidental thereto." The whole life insurance policies carried the same provisions with respect to the reserve or mortality fund, except that after the first month 50% of the first year's premium and



66-2/3% of all subsequent payments were to be placed in the reserve or mortality fund. Except for the first year, the Arizona State Corporation Commission required any new insurance policy to provide for placing of not less than 50% of the premiums in a reserve fund, which amount was deemed sufficient to enable the reserve fund to meet all requirements of the American Standard Mortality Table on the basis of 31½% interest accretions.

In its returns for the years 1939 and 1940, taxpayer claimed, by reason of its maintenance of the reserve funds for the purpose of [39] paying the benefits provided for in its insurance contracts, that it was entitled to be classified as a life insurance company for Federal tax purposes under Section 201 of the Internal Revenue Code, and should be allowed to deduct the additions to its reserve funds maintained under the laws of Arizona and its policy contracts in computing its income tax liability for each of said years.

Upon audit of the returns for the years 1939 and 1940, the Commissioner determined that the additions made by the taxpayer to its reserve funds during the years 1939 and 1940 were not proper deductions in the computation of taxable income for said years for the reason that no part of said reserve funds was held for the fulfillment of life insurance contracts within the meaning of Section 201 of the Internal Revenue Code, and issued his 90-day notice under date of July 7, 1942, setting forth deficiencies in income tax for the years 1939



and 1940 in the amounts of \$1,087.59 and \$734.53, respectively.

Under date of October 1, 1942, taxpayer petitioned the United States Board of Tax Appeals (now The Tax Court of the United States) for a re-determination of the deficiencies asserted for the years 1939 and 1940, alleging, among other things, that the Commissioner had erred (1) in determining that no part of its reserve funds was held for the fulfillment of life insurance contracts within the meaning of Section 201 of the Internal Revenue Code and that it should be taxed under Section 207 of the Internal Revenue Code, (2) that the additions made to its mortuary reserve funds during the taxable years 1939 and 1940 do not constitute additions to reserve funds required by law within the [40] meaning of section 207 of the Internal Revenue Code, and therefore are not proper deductions in the computation of its taxable income under said sections of the Internal Revenue Code, and (3) that the additions made during the years 1939 and 1940 to funds on deposit with the State of Arizona, pursuant to the Arizona Benefit Law of 1937, were not proper deductions in the computation of its income under Section 207 of the Internal Revenue Code. All material allegations were denied in Commissioner's answer filed November 4, 1942.

Since taxpayer's reserve funds maintained in compliance with its by-laws and insurance contracts exceeded the reserves required by the Arizona Benefit Corporation Laws for the fulfillment of its

insurance contracts comprise more than 50% of the total reserve funds, the Tax Court held in its opinion promulgated March 14, 1946, 6 T. C.—(No. 61), that it was a life insurance company within the meaning of Section 201 (a) of the Internal Revenue Code.

Under date of March 15, 1946, the Tax Court entered its decision, wherein it ordered and decided that there are no deficiencies in income tax for the calendar years 1939 and 1940.

/s/ DOUGLAS W. MCGREGOR,  
Assistant Attorney General.

CAR

/s/ J. P. WENCHEL,  
Chief Counsel, Bureau of Internal Revenue Counsel for Petitioner on Review.

JWS:RRZ 5-9-46

[Endorsed]: T.C.U.S. Received and Filed June 3, 1946. [41]

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[Title of Circuit Court of Appeals and Cause.]

NOTICE OF FILING PETITION FOR REVIEW

To: Z. Simpson Cox, Esquire  
406 Phoenix National Bank Building  
Phoenix, Arizona

You are hereby notified that the Commissioner of Internal Revenue did, on the 3rd day of June, 1946, file with the Clerk of The Tax Court of the United States, at Washington, D. C., a petition

for review by the United States Circuit Court of Appeals for the Ninth Circuit of the decision of The Tax Court heretofore rendered in the above-entitled cause. A copy of the petition for review as filed is hereto attached and served upon you.

Dated this 3rd day of June, 1946.

/s/ J. P. WENCHEL,

Chief Counsel, Bureau of Internal Revenue, Counsel for Petitioner on Review.

Personal service of the foregoing notice, together with a copy of the petition for review mentioned therein, is hereby acknowledged this 6th day of June, 1946.

/s/ Z. SIMPSON COX,

Counsel for Respondent on Review.

PWS:RRZ 5-9-46

[Endorsed]: T. C. U. S. Received and Filed June 18, 1946. [42]

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[Title of Circuit Court of Appeals and Cause.]

NOTICE OF FILING PETITION FOR REVIEW

To: National Reserve Insurance Company  
214 Phoenix National Bank Building  
Phoenix, Arizona

You are hereby notified that the Commissioner of Internal Revenue did, on the 3rd day of June, 1946, file with the Clerk of The Tax Court of the

United States, at Washington, D. C., a petition for review by the United States Circuit Court of Appeals for the Ninth Circuit of the decision of The Tax Court heretofore rendered in the above-entitled cause. A copy of the petition for review as filed is hereto attached and served upon you.

Dated this 3rd day of June, 1946.

/s/ J. P. WENCHEL, CAR  
Chief Counsel, Bureau of Internal Revenue, Coun-  
sel for Petitioner on Review.

Personal service of the foregoing notice, together with a copy of the petition for review mentioned therein, is hereby acknowledged this 6th day of June, 1946.

NATIONAL RESERVE INSUR-  
ANCE COMPANY,

By /s/ KENNETH K. POUND,  
Sec. and Treas.

JWS:RRZ 5-9-46

[Endorsed]: T. C. U. S. Received and Filed  
June 18, 1946. [43]

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[Title of Circuit Court of Appeals and Cause.]

#### STATEMENT OF POINTS

Now comes the Commissioner of Internal Revenue, the petitioner on review herein, by his attorneys, Douglas W. McGregor, Assistant Attorney General, and J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and hereby asserts the fol-



lowing errors on which he intends to rely in this review:

That the Tax Court of the United States erred:

1. In holding and deciding that the taxpayer was a life insurance company within the meaning of Section 201 (a) of the Internal Revenue Code and Sections 19.201 (a)-1 and 19,203(a)(2)-1 of Treasury Regulations 103.

2. In holding and deciding that the reserve funds held during the years 1939 and 1940 for the purpose of fulfilling its life insurance contracts were in excess of 50% of its total reserve funds.

3. In failing to hold and decide that the additions made by taxpayer to its reserve funds during the years 1939 and 1940 were not proper deductions in the computation of taxable income for said years, because no part of said reserve funds was exclusively held for the fulfillment of life insurance contracts within the meaning of Section 201(a) of the Internal Revenue Code. [44]

4. In entering its decision wherein it ordered and decided that there are no deficiencies in income tax for the years 1939 and 1940.

5. In failing and refusing to enter a decision redetermining deficiencies of \$1,087.59 and \$734.53 for the years 1939 and 1940, respectively.

6. In that its decision is not supported by the evidence.

7. In that its decision is contrary to law and regulations.

/s/ DOUGLAS W. MCGREGOR,  
Assistant Attorney General.

/s/ J. P. WENCHEL, CAR  
Chief Counsel, Bureau of Internal Revenue, Counsel  
for Petitioner on Review.

Statement of Service:

A copy of Statement of Points was mailed to Z. Simpson Cox, Esq., 406 Phoenix National Bank Building, Phoenix, Arizona, counsel for respondent on review this 2nd day of August, 1946.

/s/ JOHN W. SMITH,  
Special Attorney  
Bureau of Internal Revenue.

JWS:RRZ 7-30-46

[Endorsed]: T. C. U. S. Received and Filed  
Aug. 2, 1946. [45]

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[Title of Circuit Court of Appeals and Cause.]

STATEMENT OF EVIDENCE

This proceeding came on for hearing before the Honorable William W. Arnold, Judge of The Tax Court of the United States, at Los Angeles, California, on November 27, 1944. Z. Simpson Cox, Esquire, appeared on behalf of the taxpayer and the Commissioner of Internal Revenue by his counsel, Earl C. Crouter, Esquire.

The proceeding was heard on oral testimony and documentary evidence. All of the testimony introduced which is material and necessary for the determination by this Court of the assignments of error set out by the Commissioner in his statement of points is set forth herein in narrative form.

## STATEMENT OF THE CASE ON BEHALF OF THE TAXPAYER

By Mr. Cox: First of all, I would like to proceed as far as we can except for the testimony of Mr. Betts, and we would ask the Court if it will hold the case open for the purpose of taking the deposition of Mr. Betts, if necessary. He is in the White Memorial Hospital, Los Angeles, California, having been taken there for a broken collar bone [46] which he received during last night on his ride from Phoenix to Los Angeles.

Mr. Crouter: Could he testify in the latter part, say, of this week or next week, whenever he is available?

Mr. Cox: Possibly so. I haven't been able to talk to the doctor.

The Court: How long do you judge his testimony would take?

Mr. Cox: I would judge approximately 15 minutes.

The Court: We can arrange to get that in some time later, if that is satisfactory?

Mr. Crouter: That is agreeable.

The Court: You may state the nature of the



case and what you expect to cover by your testimony.

Mr. Cox: This case involves income taxes for the years 1939 and 1940. The taxpayer was incorporated in 1934 under and by virtue of the laws then in existence in the State of Arizona, under the name of Franklin Mutual Benefit Association, which was later changed to Family Group Union, and then on April 22, 1928 to National Reserve Insurance Company, which it now is.

The taxpayer has done business during all of the times herein involved under Chapter 36 of the 1937 Session Laws of Arizona, which was incorporated in the present Arizona Code, Annotated, 1939, as Article 6, Chapter 53, and became effective on June 12, 1937, and that same law was in effect during the years 1939 and 1940. At all times necessary for the determination of this case, taxpayer was engaged in business under this Statute and in no other business whatsoever. The statute is known as the Benefit Corporation Law of 1937. [47]

The taxpayer was in the business of issuing policies of life insurance and combined life and accident insurance. All policies, except some that were initially issued in 1936, provided for a reserve or mortuary fund, variously entitled as reserve, or mortuary fund, or death benefit fund, or a reserve fund for the purpose of paying claims under the policies; and the by-laws of the corporation also required setting aside a percentage of the premium income into this reserve fund. The policies all made the by-laws a part of the policy. All of the policies,



except the one mentioned, provided for 66-2/3 per cent of the premium income after the first year, and the first policy mentioned was handled in the same manner, in accordance with the by-laws incorporated in the policy during the years in controversy. During the first year, after the first month's premium, most of the policies provided for 50 per cent of the ensuing eleven monthly premium payments to be paid into this same reserve fund.

In 1940 a new policy was issued, which provided for 26 per cent after the initial month for the next ensuing eleven months, and all of them provided for the 66-2/3 per cent thereafter.

Under the Benefit Corporation Law of 1937, the taxpayer has at all times involved in this controversy been under the jurisdiction of the Arizona Corporation Commission, which is constitutionally, and by that statute, particularly, charged with the regulation of the taxpayer. At all times after the effective date of the Act, June 12, 1937, the Commission has refused to approve or authorize the use by taxpayer of any form of policy that did not provide that after the first year from date of issuance at least 50 per cent of all premium payments be credited and placed in the mortuary and reserve fund contemplated by the Benefit [48] Corporation Law of 1937. The funds were created and maintained by taxpayer in accordance with the provisions of the policies, the regulations of the Corporation Commission, and the by-laws, which were a part of the policy, and by reason of the Benefit

Corporation Law of 1937. Under that law, it also was required that taxpayer make deposits to the State Treasurer of the State of Arizona. During the year 1939, taxpayer deposited with the State Treasurer the sum of \$166.70, and for 1940 the sum of \$789.47. Taxpayer's deposits into its mortuary and reserve fund will also be shown by the evidence. Taxpayer had no other income than premium income during the years 1939 and 1940. Taxpayer's entire income was from premium income, except for the sum of \$206.92.

The Court: What is the question at issue in this case?

Mr. Cox: The first question is, is taxpayer a life insurance company as defined by Sections 201 and 202 of the Internal Revenue Code, or if not, is taxpayer taxable under Section 207. The second question relates to the deduction allowable under Section 207.

#### STATEMENT OF THE CASE ON BEHALF OF THE COMMISSIONER

By Mr. Crouter: In this case the Commissioner determined, as stated in the deficiency notice, that no part of the reserve funds of the taxpayer is held for the fulfillment of life insurance contracts within the meaning of Section 201 of the Internal Revenue Code, and that taxpayer is subject to tax under the provisions of Section 207 of the Internal Revenue Code. Also, that the additions made during the taxable years to mortuary reserve and to funds on deposit with the State of Arizona do not con-

stitute additions required by law to be made within the respective taxable years [49] to reserve funds, within the meaning of Section 207 of the Code, and are, therefore, not proper deductions within the meaning of taxable income under Section 207.

The Court will probably recall that a number of matters with respect to life insurance classification are left by the statute to be controlled by the regulations, and the regulations have been consistent, as have several Revenue Act, with respect to exactly what constitutes a mortuary fund,—a mortuary reserve, which is set aside and definitely maintained for the payment of death claims, and nothing else, and they have definitely provided that such a fund shall not be available and cannot be made available for ordinary running expenses.

It is the Commissioner's position that, so far as we have been able to ascertain and so far as we know now, this company did not maintain the required mortuary reserve in order to be entitled to classification under Section 201(a) of the Revenue Act of 1938 and the Internal Revenue Code. That is chiefly because of the nature of that mortuary reserve, but also on account of the procedure there, which is somewhat uncertain in my mind, as to the State requirement. I am doubtful whether a true reserve, in the sense of the revenue requirement, was even required, as a matter of fact, by the State Insurance Commissioner. Whether it was required as a matter of printed regulations or State statute, I am not prepared to state.

The Court: Very well. You may call your first witness.



## WILLIAM WAHL

was called as a witness for and on behalf of the taxpayer, and having been first duly sworn, was examined and testified as follows: [50]

## Direct Examination

By Mr. Cox:

The Witness: My name is William Wahl. During the years 1939 and 1940 I was employed by the National Reserve Insurance Company, keeping its books during that time. During said years there were deposited with the State Treasurer of the State of Arizona \$167.67 and \$789.47, respectively. During the year 1939 the total premium income for mortuary purposes was \$11,990.08, and for operating or expense fund purposes \$17,858.15. That was the total income for those two purposes during the year 1939. For the year 1940 the total income for mortuary purposes was \$14,514.16, and for expense purposes \$28,061.63. These amounts were derived entirely from premiums. There was no interest income during the year 1939. During the year 1940 \$206.92 was received from interest on invested funds.

During the year 1939 the net amount deposited to the mortuary reserve fund was \$6,564.11, and for 1940 it was \$4,680.82.

Q. Did this figure include the amount deposited with the State of Arizona?

A. It did not.

Q. As premiums were received in the office, were



(Testimony of William Wahl.)

you familiar with the breakdown on those premiums?      A. Yes, sir.

Q. First let's take the first month's premiums on policies. What about those?

A. That was allocated 100 per cent to the expense fund. [51]

Q. And not from a bookkeeping standpoint, but actually what happened with that money?

A. Well, that was primarily commissions paid and was retained by agents in the field.

Q. Is the same true on membership fees shown——

A. That is correct.

Q. ——on the deficiency statement?

A. That's right.

Q. Now, as to membership fees, how was that set up on the books, Mr. Wahl?

A. We just made an arbitrary entry from the standpoint of income, setting up a per policy amount, as set up in the policy, allowable in the policy for membership fees, and then we made a journal entry to just offset it in total, because that money did not come into the office. We were not in a position to account for it, because it was the practice of agents in the field—some of them collected it, others did not, and we were unable to determine just how much of that money was actually collected by the agents, so that we could pick it up as income, and at the suggestion of the Department over there, we just made an arbitrary entry of that, and it was accepted by the State

(Testimony of William Wahl.)

Auditors on every audit that they made of our books. So that was just an in-and-out item, and did not represent actual receipts by the company.

Q. After the first month's premium, a portion of the premium on most of the policies was allocated to the mortuary reserve fund. Now was that handled? [52]

A. As the money was received, we set up what we called a daily receipts spread, and on that spread we indicated the policy number, the name of the policy holder, and made our allocation to the two funds out of each item, in accordance with the contracts involved, and we carried that total through to the end of the month, and then journalled it into our cash receipts journal, and from there to the general ledger. But that split was made of every item, as we received it, every day.

Q. Then those funds for the mortuary reserve were entered separately and kept separately?

A. Absolutely. They were not even entered as income for operations at all.

Q. I notice from the auditor's report during the years 1939 and 1940 there was a deficiency in the expense fund?

A. That is right.

Q. As a result of that, do you know what had to be done there?      A. Yes, I do.

Q. What? Will you state what that was?

A. The officers of the company were required to bring that—replace that money so that the difference between the deficit in the expense fund and

(Testimony of William Wahl.)

the requirements in the mortuary fund would not be affected by that deficiency. In other words, they had to bring in acceptable assets, either in the way of cash or bonds, to bring up the deficiency. Otherwise, theoretically they would interpret our mortuary fund as being short whatever we overspent in the expense fund, and they were required by the Department to bring that mortuary fund up to the required limits, as set up in our books. [53]

Q. Were expenses payable from the mortuary fund?

A. None, except for claims.

Q. Of the money deposited with the State Treasurer of the State of Arizona, was any of that withdrawn, in whole or in part, from the depositary during the years 1939 or 1940?

A. If I get your question correctly, the only withdrawal that might be made would be from the standpoint of converting cash on hand with the Department, that is, the Insurance Department, into bonds, or something like that. There was no withdrawal from any deposits made to the State of Arizona.

Q. In other words, the company had some \$1,866.00 and some cents, or some such figure, in cash on deposit, and that was substituted by \$2,000.00 in United States bonds—

A. That is correct.

Q. —during the calendar years 1939 and 1940?

A. Yes.

Q. Do you know whether or not the company



(Testimony of William Wahl.)

did submit all of its policies to the Arizona Corporation Commission for approval?

A. They did. That was a requirement of the Department, of the Arizona Corporation Commission.

Q. Do you know, of your own knowledge, whether or not the Corporation Commission made any requirement as to deposits in the mortuary reserve fund?

A. I do. We wouldn't have been able to operate unless we had it.

Q. The Commission did require it?

A. Absolutely. [54]

Q. Was there a definite requirement as to percentage, and do you recall that?

A. It had to be at least 50 per cent.

Mr. Crouter: Is that pursuant to a written regulation?

The Witness: Yes.

Mr. Cox: I believe—I know it is oral, and I believe there is a written regulation.

The Witness: Yes.

By Mr. Cox:

Q. It is a written regulation?

A. Yes.

Mr. Cox: We offer in evidence as Petitioner's Exhibit 1 the policies of insurance in force during the years 1939 and 1940.

Mr. Crouter: As I understand it, this is just a copy of each representative policy?

Mr. Cox: Each representative policy, yes.



(Testimony of William Wahl.)

Mr. Crouter: And that there were different policies, various policies of these different kinds in force during those two years?

Mr. Cox: May I get you right? There might have been a thousand or two thousand policies written of each kind.

Mr. Crouter: Yes. And these are just blank forms, are they?

Mr. Cox: Yes.

Mr. Crouter: No objection.

The Court: They will be received in evidence as Petitioner's Exhibit No. 1. [55]

(The policy forms referred to were marked and received in evidence as Petitioner's Exhibit No. 1.)

By Mr. Cox:

Q. Did the National Reserve Insurance Company during the years 1939 and 1940 have any other reserve funds other than the mortuary reserve funds you have spoken of?

A. We ordinarily referred to the expense fund as a reserve fund for expenses. That is all, just those two funds, the mortuary fund and the expense fund.

Q. Then from the inception of the company up until or after the year 1940, I believe it was 1941, the expense fund was usually in the red; is that not correct?

A. That is correct.

Q. And was either charged against non-admitted assets or was just out and out in the red?

(Testimony of William Wahl.)

A. That is right.

Q. Were any of these policies which I show you as Petitioner's Exhibit 1, under which reserves were not set apart during the years 1939 and 1940, to the mortuary reserve fund which you testified to?

A. No, each policy here carried a certain required portion to the mortuary fund.

Q. I call your attention to one of the policies wherein there is no provision in the general provisions of the policy for funds, or if there is, I have been unable to find it. That is one of the first policies, I believe, written by the company (handing document to witness)? [56]

A. Well, it refers to the by-laws, and the by-laws specify that there must be a certain amount of money set aside for mortuary purposes.

Mr. Cox: I offer in evidence as Petitioner's Exhibit 2 the articles of incorporation of the company, and ask that a copy be substituted, subject to the examination of counsel for the Respondent in checking it with the originals, which are here available.

Mr. Crouter: Yes. There is no objection on the Respondent's behalf as to the copy going in, under the circumstances stated.

The Court: Very well. It will be received in evidence as Petitioner's Exhibit No. 2.

(The articles of incorporation referred to were marked and received in evidence as Petitioner's Exhibit No. 2. )

Mr. Cox: And we offer as Petitioner's Exhibit

(Testimony of William Wahl.)

No. 3, under the same circumstances, the by-laws of the company.

Mr. Crouter: No objection.

The Court: It will be received in evidence as Petitioner's Exhibit No. 3.

(The by-laws referred to were marked and received in evidence as Petitioner's Exhibit No. 3.)

Mr. Cox: I will state the only change from the originals which I have are the name changes in the articles of incorporation, which is on a separate paper, but it is incorporated directly in the original articles.

By Mr. Cox:

Q. I refer you to Article XVI of the by-laws, and ask you if that is the article of the by-laws to which you referred?

A. That is correct. [57]

Q. And even the one policy which did not provide specifically for funds was handled in that same manner?

A. That is right.

Q. That policy, which was the last policy in the exhibit, was only issued for a short time; is that not correct?

A. That is right.

Q. Then all subsequent policies provided for the mortuary reserve fund?

A. That is correct.

Q. As to the funds in the mortuary fund, they came from premium income alone and no other source; is that correct?



(Testimony of William Wahl.)

A. That is correct.

Mr. Cox: That is all.

### Cross Examination

By Mr. Crouter:

Q. Mr. Wahl, do I understand that you were the Petitioner company in 1939 and 1940?

A. That is correct, sir.

Q. Now, referring to Petitioner's Exhibit No. 1 in evidence, without taking the time to go through all these policies, are these all copies or specimens or representative policies of life insurance?

A. Yes, sir.

Q. That were written on the life of some individual?

A. That is correct. These can be either used for an individual, or if there are several individuals in the same family, why, they could be covered, were used to cover a family group. [58]

Q. That is as to beneficiarcies?

A. No, this (indicating) is the name of the insured, and there could be several, several could be insured there.

Q. Oh, you write a group policy in a sense?

A. That is right.

Q. As I understand, all of these various specimens were written during the two years, 1939 and 1940?

A. That is right.

Mr. Crouter: Yes, my question is whether policies of this type were written and these are representative of those policies that were actually exe-



(Testimony of William Wahl.)

cuted between the company and insured persons. As I understand it, these are offered as specimens of policies which were actually executed.

Mr. Cox: I don't want any confusion, Mr. Crouter. The policies are in the order they were printed. This, as you can see by the name on the particular one, is the Family Group Union Association, and then as they became older, it was changed to National Reserve over here. During 1939 these other policies—well, these (indicating) were the only two that were written.

By Mr. Crouter:

Q. Counsel points out to me that the four documents, the last four nearest the bottom here, were policies of a different association. Were they?

A. No, they were the same association, except under these contracts the name had been changed from Family Group Union Association to the National Reserve Insurance Company, but it was the same management, the same set-up exactly.

Q. Well, it was only the National Reserve Insurance Company which [60] issued policies during the two years we have here, wasn't it?

A. I believe that is correct. Those dates would have to be confirmed from the minutes.

Q. That is what we want to find out in this case, exactly what kinds of policies were issued during these two years, 1939 and 1940. I believe you can answer this: Referring to these last four policies in this Exhibit 1, which show that they were issued by Family Group Union Association,

(Testimony of William Wahl.)

were such policies or similar forms outstanding during 1939 and 1940?

A. That's right, yes.

Q. The policies of the type shown by the first three specimens from the top down in this exhibit are of the kind which were issued by National Reserve Insurance Company?

A. That is right.

Q. During the taxable years?

A. That is right.

Q. And policies of that type also were outstanding from the date of issuance?

A. That is correct.

Q. Were policies of that kind issued before 1939?

A. That date—you would have to confirm that date.

Q. Well, the record shows there was a change of name of the corporation in 1936. Is that correct?

Mr. Cox: There was no business done by the National Reserve Insurance Company from the date of its incorporation in 1934 until 1936, at which time its name was changed from Franklin Mutual Benefit to the Family Group Union Association, and on April 22, 1938, the name was changed from Family Group [60] Union Association to National Reserve Insurance Company. But the articles of incorporation and the by-laws and policies all remained identical. It wasn't a new corporation.

Mr. Crouter: Now, referring to the——

(Testimony of William Wahl.)

The Court: That is to be considered in the record, is it?

Mr. Crouter: That is his counsel's explanation. I believe it is helpful. It is not directly material on the issues.

The Court: Very well.

By Mr. Crouter:

Q. Referring to the first paper in Exhibit 1, here, in the provision here, "Reserve or Mortality Fund," that reads:

"After the first month 25% of the first year's premium and 66-2/3% of all subsequent payments will be placed in this fund, for the purpose of payment of claims and expenses incidental thereto."

A. That is correct.

Q. Now, is there a similar provision in these other policies? A. Yes.

Q. The second one apparently is identical, isn't it? A. Yes.

Q. That is paragraph 11 of the second policy from the top down?

A. Reserve or mortuary fund, yes.

Q. The third policy has 50 per cent instead of 25 per cent, does it not? A. Yes.

Q. The third one reads, for the record:

"After the first month (50%) of each payment of the first year's premium and (66-2/3%) of all subsequent payments will be placed in this Fund, for the purpose of payment of claims and expenses incidental thereto."

I notice that the form is one which apparently



(Testimony of William Wahl.)

was issued by Family Group Union Association? [61]

A. Yes.

Q. Or is a type issued by them, and also has a similar provision of 50 per cent for the first year and 66-2/3 per cent for subsequent payments?

A. That is right.

Q. Now, by following questions will relate particularly to the monies which were actually paid to the company and handled by the company. Now, first, as to the \$167.67 which you testified about, which was deposited with the State Treasurer, just what was the background of that, and why was that amount deposited?

A. Could I show you this ledger sheet?

Q. Yes, I will be glad to see it. Do I understand this is a ledger of the Petitioner's?

A. This is the original ledger sheet of the Petitioner. When these companies began business under this Arizona Statute, they were required by a certain day to have on deposit with the State of Arizona \$2,000.00 and so this company started—made their first deposit back here in September of 1937. They deposited \$1,000.00. There is the cash journal sheet number, and they came down to the end of—or down to this date in 1938, when we had on deposit in cash with the State of Arizona \$1,833.30.

Q. That is at the end of 1938?

A. That is right.

Q. Now, right there, is that a fund which is



(Testimony of William Wahl.)

tied up with your State Insurance requirements, or does that relate to something else?

A. That is required by the State Insurance requirements.

Q. Do you know what that requirement is? Is that a printed instruction or regulation? [62]

A. That is a printed instruction which said all mutual companies to start must have a certain number of members, and within a given length of time they must have on deposit the sum of \$2,000.00, and that each year thereafter, until they have on deposit with the State \$10,000.00, a given percentage must be deposited, which in some cases was—well, it was one per cent of your revenue each year, had to be deposited with the State of Arizona until the entire fund was \$10,000.00.

Mr. Cox: This is objectionable. This is all a part of the statute. I mean, this is statutory.

Mr. Crouter: But I want to get at the figures, what was actually done.

Mr. Cox: Well, that is one percent.

By Mr. Crouter:

Q. That one percent, did it constitute one percent of all premiums paid, we will say—that one percent?

A. That one percent would be based upon all premiums paid.

Q. So that at the end of 1938 the total amount was \$1,833.30? A. Yes.

Q. Is that the only amount that was on deposit

(Testimony of William Wahl.)

with any branch of the State Government there in connection with insurance business?

A. That is right.

Q. All right. Now, was that same account maintained through 1939 and 1940?

A. Yes, that is right.

Q. Now, what, if anything, would be charged against such an account? Would that be used to guarantee payments of judgment recoveries, or anything of that sort? [63]

A. If the company became inoperative and there were outstanding claims after a company was adjudged incapable of operating further, from the standpoint of the public good, then they would have the amount of money to liquidate outstanding claims.

Q. In 1939 were there any addition to that fund?

A. In 1939 we took this money down in cash and substituted \$2,000.00 worth of bonds. They were United States Savings Bonds, Series G, so that during 1939 we made an addition to the fund of that difference right there, that \$167.70.

Q. Now, what is that \$2,000.00—the face amount or the real cash value of those bonds?

A. That was the face amount.

Q. So that the sum might be more nearly equal to the exact amount which was withdrawn?

Mr. Cox: Well, I think the Court will take judicial notice that Series G bonds are payable in their face amount.

(Testimony of William Wahl.)

Mr. Crouter: Very well. I hadn't checked that recently. I didn't know that was the type you had.

The Witness: Those are.

By Mr. Crouter:

Q. Now, at the end of 1939, what was the total amount you had with any branch of the State in connection with insurance business?

A. \$2,000.00.

Q. Those bonds? A. Yes, sir. [64]

Q. Was there any change in 1940?

A. Yes, sir.

Q. What change was there?

A. In January we put in \$789.47.

Q. Was that in addition to the bonds?

A. In addition to the bonds. That was in cash,

C. D. Page 71.

Q. Were those payments merely in accordance with the one percent requirement which has been referred to? A. That is right.

Q. One percent of the premium payments?

A. That is right.

Q. Referring to your testimony about your premium income and the allocation of a certain total to the mortuary fund and also a total to operating expense fund, how were those allocations determined?

A. On the basis of the requirement in the policy contract, and those, of course, were approved on the basis of what we looked upon as the State Statute and the State requirement.

Q. Have you given to the Court here all the



(Testimony of William Wahl.)

figures regarding total premium income,—I mean the total amount of premium income on all policies? Is that the total of all?

A. It is. The sum of the two would be the total of it.

Q. And no other funds?

A. And no other funds.

Q. No part of the premiums then have been recorded or allocated to any other account?

A. No, sir.

Q. Then looking at your 1939 figures, which you gave in your testimony on direct, as I recall it, your figures were \$11,990.00 and something, and that amount as given was allocated to the mortuary fund?

A. That is correct.

Q. And you had \$17,858.15 allocated to the expense fund?

A. That is correct.

Q. How much, if any amount, did the State require be allocated for general operating expenses?

A. Well, everything that—any amount outside of the mortuary fund requirements would be for operating expenses.

Q. Do you know whether that was a certain percentage of the State requirements, or what it was based upon?

A. I don't think that it would be upon a specifically named percentage, excepting that it was to be sufficient to carry the necessary reserves. All

(Testimony of William Wahl.)

these contracts are on the same basis and all reflect the American Experience Mortality Table.

Q. Did the Petitioner at the end of 1939 have an exact sum in cash of \$11,990.08 actually maintained in any definite place for this purpose alone?

A. That is right.

Q. Where was that?

A. Either in the bank or in bonds, or on deposit with the State.

Q. Would it be in all three of those places?

A. It could be.

Q. Let's see how this is marked. I mean, is that your original record?

A. No. This is—oh, on my original record? [66]

Q. Let's see how any of those funds are kept on the original record?

A. Well, you take for instance,—let's get back to some of these transfer sheets. We tried to get these in shape last night, and we had our troubles.

Q. If you can show me any total making up a part of that, or representative items in the captions of your accounts, will you do that?

A. Yes, I can do that. Let me have the book of minutes, please. I want a statement of the status of our mortuary fund. This will give it to you, Mr. Crouter.

Q. Do you have some part of an item of \$11,990.00 in mortuary fund for 1939?

A. This is at the end of 1939. This is an analysis of the mortality fund as of December 31st. Net

(Testimony of William Wahl.)

requirement in reserve account, \$14,509.00. That is our figure, isn't it?

Q. This is a loose-leaf notebook. Is that an original record?

A. This is our minute book.

Q. Your minute book?

A. And this report was submitted to the officers of the company by me, as a part of my annual report for 1939, and was made a part of the minutes.

Q. Now, is that a figure which was merely computed in accordance with the State requirement to show what reserve you should have at the end of that year and that you were required by law to have?

A. That is right.

Q. I notice it reads, "Net reserve in accounts for future death claims," and you have an item of \$14,509.99?

A. That is right. [67]

Q. And to make the rest of the total there, there is another net requirement in reserve account for future sick and accident claims, \$149.58; total reserve for all claims, \$14,659.57?

A. That is right.

Q. That was just a bookkeeping record then of the company, wasn't it?

A. No.

Q. To show the legal requirements as to reserves?

A. No—yes, it is a bookkeeping record.

Q. But did it represent any actual funds of that identical amount which was maintained any place?

A. Yes, and here is the history of it. We had



(Testimony of William Wahl.)

deposited in the Valley National Bank, \$5,325.07; deposited in the First National Bank, \$2,500.00; cash on hand, \$432.68; cash on deposit in the State of Arizona, \$2,000.00; secured by note receivable, Mitchell, \$285.00; secured note receivable, Tyler, \$52.16.

Q. Did you have a similar analysis, then, for 1940?      A. I believe so.

Q. There is a summary that can be located here for 1940?      A. Yes, it can.

Q. With respect to that same exhibit you have here for 1939, and taking that as representative, have you computed the exact percentage so that you can say whether it is within the 50 per cent requirement in some of the policies, or as to all policies, or it is less in some cases?

A. No, except for the first year, the contract provides that in the first year certain percentages which can be less than 25 per cent [68] are to be set aside for mortuary purposes, but after the first year a minimum of 50 per cent, and in all contracts we put 66-2/3 per cent into the mortuary fund.

Q. Why for 1939, then do we have a figure of \$17,000.00 plus for operating expenses, and only \$11,990.00 for your mortuary fund?

A. Oh, I see where our difficulty is. This is the net requirements after having paid the death claims. From our total income in 1939 for mortuary purposes, we received \$11,990.08 and we had an inventory fund from the previous year of \$8,095.46. I would be glad to put this in as an exhibit, if you

(Testimony of William Wahl.)

need this. We disbursed for claims \$5,425.00, leaving a gain in the mortuary fund for 1939 of \$6,564.67, which added to our inventory gives a required mortuary reserve of \$14,659.57, which is that which is set forth in this exhibit that we talked about.

Q. You are familiar with the fact, are you not, that there was considerable controversy between the insurance companies over there and the Insurance Commissioner as to whether, in the first place, the State Insurance Commissioner could regulate your insurance companies in Arizona?

A. There was some controversy on that point.

Q. And wasn't there a suit of the Pioneer Mutual Benefit Association against the Corporation Commissioner on that subject?

A. Yes.

Q. Do you recall that that went to the Supreme Court and was decided by that court in 1942?

A. Yes. [69]

Mr. Cox: I object. The citation can be given to the Court, and this whole thing is a question of law.

Mr. Crouter: I will be glad to stipulate that we can both refer to that case and merely consider it for reference purposes in connection with the case here, if that is agreeable?

Mr. Cox: Yes.

The Court: So understood.

Mr. Crouter: The case is the Pioneer Mutual Benefit Association vs. Corporation Commission, decided in 1942, 123 Pacific 2nd 828.

(Testimony of William Wahl.)

By Mr. Crouter:

Q. In 1939 and 1940, what position did the Petitioner take with respect to the authority of the Corporation Commission to regulate its insurance requirements?

A. May I just elaborate what I really know about that particular situation, which probably will better answer your question.

Q. Well, can you answer the question according to your own knowledge? A. Yes.

Q. I would like to have it answered, as best you can. It has a bearing on the maintenance of a mortuary reserve. That is what we are chiefly interested in.

A. Our position was it was required.

Q. And was a definite sum maintained, in accordance with the State Regulations?

A. That's right.

Q. Even though other companies were contesting it?

A. That is right. They all had to maintain it. [70]

Q. But it was maintained among your own records in the manner you have indicated for 1939?

A. Yes, sir.

Q. Do you know whether 1940 was similar, as to bonds, and cash, and so forth?

A. It was.

Q. Now, referring to the figures you have in that table, like the \$17,000.00 for operating ex-



(Testimony of William Wahl.)

penses, is that a residuary figure also, after expenses for the year have been paid?

A. That is correct.

Q. Do you have any figures there that you could supply us, perhaps in a table, showing the amount at the beginning of the year and the amount expended by months?

A. We can give it for both years.

Q. We might have it worked up so that we could have it presented at the next session on the case here. Mr. Wahl, was there any element of discretion left with the company officers as to how much would be allocated to the mortuary fund and how much for insurance, incidental expenses, and so forth?

A. No, there was not, after the policy contract was approved.

Q. Well, would each policy be specifically approved in the Insurance Office, or just the form of it?

A. No, each policy would be specifically approved.

Mr. Cox: I am sure he is mistaken on that. You mean by "each one," written for each individual to whom it was issued?

Mr. Crouter: That is my question. [71]

The Witness: Oh, I misunderstood you. Each policy form. I am sorry.

By Mr. Crouter:

Q. In connection with the portion maintained for claims, a part of that was just for operating

(Testimony of William Wahl.)

expenses or could be used for operating expenses in connection with claim investigations, couldn't it?

A. Well, the statute under which we were operating provided that expenses incidental to the settlement of claims were an acceptable deduction from our mortuary fund and could be paid out of that fund, but nothing else.

Q. Could attorney's fees, for instance, in contesting a claim?

A. Could be interpreted that way, yes sir.

Q. Do you know as a fact whether attorney's fees were paid out of either of those funds, or it would be out of your expense and claim fund for both of the years involved here?

A. They could have been.

Q. Do you know, in fact?

A. I would have to refer to the ledgers here. There could have been and there might have been. I would have to refer to the ledger to see.

Q. I would like to have you do that before we continue this case. Mr. Wahl, will you kindly examine what I understand to be the 1939 return of the Petitioner and state whether that is the original (handing document to witness)?

A. That is, sir.

Mr. Crouter: The Respondent offer this, if the Court please. I believe it is agreeable to do so out of turn.

Mr. Cox: No objection. [72]

Mr. Crouter: The record shows this is the 1939 original corporation income and excess profits re-

(Testimony of William Wahl.)

turn of the National Reserve Insurance Company for the calendar year 1939, filed with the Collector for the District of Arizona.

The Court: It will be received in evidence as Respondent's Exhibit A.

(The corporation income and excess profits return for 1939 referred to was marked and received in evidence as Respondent's Exhibit A.)

Mr. Crouter: The 1940 return also is offered.

By Mr. Crouter:

Q. Is that the original (indicating)?

A. That is the original, sir.

Mr. Crouter: That is offered in evidence.

Mr. Cox: No objection.

The Court: It will be received in evidence as Respondent's Exhibit B.

Mr. Crouter: That is a similar return for 1940 of the same Petitioner, and it was filed in the District of Arizona.

(The corporation income and excess profits return for 1940 referred to was marked and received in evidence as Respondent's Exhibit B.)

Mr. Crouter: I think that is all, if the Court please.

The Court: Anything further of this witness?

Mr. Cox: I would like to straighten out one matter.



(Testimony of William Wahl.)

Redirect Examination

By Mr. Cox:

Q. You stated one percent was required by the State, Mr. Wahl. I refer to the Act which requires \$1.00 out of every thousand, and I would like to correct that. [73]

Mr. Cox: That is right. I believe the Court will take judicial notice of the laws of the State of Arizona, and would the Court particularly like to have this?

The Court: I suggest you had better put it with the record, so that it will be convenient.

Mr. Cox: I have plenty of copies of this Act here he is referring to.

The Witness: I was mistaken there, Mr. Cox.

By Mr. Cox:

Q. What is that?

A. That is \$1.00 per thousand.

Q. Per thousand.

A. Per thousand of insurance; \$1.00 per thousand of insurance in force.

The Court: If you want to introduce the statute of the State,—

Mr. Cox: Yes, I do.

Mr. Crouter: That is agreeable to me.

The Court: It will be received in evidence as Petitioner's Exhibit 4.

(The statute referred to was marked and received in evidence as Petitioner's Exhibit No. 4.)

(Testimony of William Wahl.)

Mr. Crouter: I would merely like to have the understanding that if there should be any correction between this and the official edition——

Mr. Cox: They may be made, yes. This was furnished to me by the Secretary of State as a mimeographed copy.

The Court: Very well. Anything further?

Mr. Cox: That is all.

Mr. Crouter: Just one question, if the Court please. There is one question I neglected to ask before.

The Court: Very well. [74]

#### Recross Examination

By Mr. Crouter:

Q. Referring to Exhibit 3 in evidence, and Article XVI to which your attorney referred, I notice that this provides that the death benefit fund shall be created, maintained, and so forth, 50 percent for the first year and then 66-2/3 percent. And then it has this provision, "The money in the Death Benefit Fund shall be used for the payment of death losses, however, the Board of Directors may set aside a portion of the savings in said fund for the purpose of organizing a legal reserve life insurance company, and shall issue in January of every year", a certain certificate and so forth.

A. Yes.

Q. Now, was that provision still in effect in 1939 and 1940?

A. Yes.

(Testimony of William Wahl.)

Q. Was that a part of the fund you referred to here,—those figures?      A. That was.

Q. Can you tell us how much of it was used for this purpose?

A. You mean on this exhibit here?

Q. Yes, the funds allocated to mortuary and to claims?

A. No, that exhibit here is after the deduction has been made for refunds to policy holders referred to in here.

Q. Could you also give us figures, then, as to how much was handled under Article XVI here for each of those years?      A. For this purpose?

Q. Yes.      A. Yes, we can. [75]

Q. Are those figures summarized so that you can give them now, or would you have to work through here to do so?

A. As I say, I owe you an apology for being at a disadvantage here, but as I say I didn't see these books until last night——

Mr. Cox: I would like to ask one question in connection with this cross examination.

The Court: Very well.

#### Redirect Examination

By Mr. Cox:

Q. Is it not true that the Commission required cash refunds to policy holders under the provision of Article XVI of the by-laws referred to?

A. That is right.



(Testimony of William Wahl.)

Q. And the money referred to therein as a portion of the savings in said fund, that was interpreted as a portion of the net amount set aside during each calendar year; is that correct?

A. That is right.

Q. And the requirement there for 50 per cent of the first year's assessment and 66-2/3 per cent thereafter was in excess of the amount required by the Commission for mortuary purposes?

A. Yes.

Q. The excess premium charged has been by order of the Commission refunded in cash to policy holders; is that correct?

A. Yes, that is right, or the net amount shown in mortuary funds is after making refunds.

Q. To policy holders?

A. To policy holders. [76]

Q. Those refunds are shown in the deficiency statement of the Collector of Internal Revenue, are they not?

A. Yes, that is right.

Q. And the refunds mentioned in that deficiency statement is the same money that is referred to in Article XVI of the by-laws; is that correct?

A. Yes, under the refunds to members, that is right.

Mr. Cox: That is all.

Mr. Crouter: No further questions.

The Court: Very well, gentlemen. You have just the one witness now?

Mr. Cox: Just the one witness, your Honor.

(Testimony of William Wahl.)

The Court: Then we will suspend until 9:30.

The Court: And now that you gentlemen know what Mr. Crouter wants, I suggest you get that data up for him, and as to things that are facts, there is no use in taking the time and the attention of the witness in proving them; when we know they are facts, because that is what we want to get in here.

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The hearing in the above-entitled proceeding was resumed on this, the 28th day of November, 1944, before the Honorable William W. Arnold, Judge of The Tax Court of the United States, pursuant to adjournment heretofore taken.

Appearances: (Same as heretofore noted.)

### PROCEEDINGS

The Clerk: Docket No. 112638, National Reserve Insurance Company.

Mr. Cox: May it please the Court, during the evening counsel got together and obtained the figures from Mr. Wahl we deemed necessary and [77] we agreed wouldn't need Mr. Wahl further. We ask Mr. Wahl be deemed excused by this Court. Mr. Crouter has some exhibits to offer.

Mr. Crouter: That is agreeable.

The Court: That is all right.

Mr. Cox: I offer the official minutes of the company, the company's copy of the general Order

No. 160-1 from the Arizona Corporation Commission.

Mr. Crouter: No objection.

The Court: It will be received in evidence as Petitioner's Exhibit No. 5.

(The said minutes so offered and received in evidence was marked Petitioner's Exhibit 5, and made a part of this record.)

Mr. Cox: I offer in evidence from the official minutes of the company the company's copy of general Order No. 165-1 from the Arizona Corporation Commission.

Mr. Crouter: I have no objection.

The Court: It will be received in evidence as Petitioner's Exhibit No. 6.

(The said minutes so offered and received in evidence was marked Petitioner's Exhibit 6, and made a part of this record.)

Mr. Cox: May it please the court, that is all of my offer at this time. Mr. Crouter has some offer concerning Mr. Wahl's testimony.

Mr. Crouter: If the court please, I just have a few documents to offer here. The respondent would like to offer at this time a verbatim copy of a document, the original of which was identified by Mr. Wahl yesterday. That is an analysis of the mortality fund as of December 31, 1939. Under his testimony, as I recall, that was contained in the [78] loose-leaf notebook he testified about.

Mr. Cox: The official minutes?



Mr. Crouter: The official minutes.

The Court: Is there any objection?

Mr. Cox: It may be received. I have no objection.

The Court: It will be received in evidence as Respondent's Exhibit C.

(The said analysis so offered and received in evidence was marked Respondent's Exhibit C, and made a part of this record.)

Mr. Cox: Might I ask your Honor, if Exhibits A and B are in evidence, the tax returns?

The Court: My notes so show it.

Mr. Crouter: The respondent also offers, if the court please, a summary from the records of the petitioner headed "Mortuary Fund Balance in Reserve January 1, 1939", and also showing the total reserve at the end of December, December 31, 1940. In other words, it covers the two-year period here. I offer that as Respondent's Exhibit D.

Mr. Cox: I have no objection.

The Court: It will be received in evidence as Respondent's Exhibit D.

(The said summary so offered and received in evidence was marked Respondent's Exhibit D, and made a part hereof.)

Mr. Crouter: The respondent also offers a schedule showing an analysis of mortality fund as of December 31, 1940. This particularly shows the exact location of the various items comprising the total. That would be Exhibit E. [79]

The Court: Do you have any objection?

Mr. Cox: No objection, your Honor.

The Court: It will be received as Respondent's Exhibit E.

(The said schedule so offered and received in evidence was marked Respondent's Exhibit E, and made a part hereof.)

Mr. Crouter: The respondent would also like to offer, the original of the petitioner's general ledger account which is headed "Income-Premium Renewals-Mortality Fund." This comprises three original sheets from the general ledger, with writing and figures on both sides. If this is received we would like to have permission to withdraw the original and substitute a photostatic copy for the original, so the original may be returned.

Mr. Cox: There is no objection.

The Court: It will be received as Respondent's Exhibit F.

(The said general ledger account so offered and received in evidence was marked as Respondent's Exhibit F, and made a part of this record.)

The Court: Leave will be given to withdraw the original upon substitution of a photostatic copy.

Mr. Crouter: That comprises the Respondent's case, if the court please.

Mr. Cox: Mr. Amos Betts is still in the White Memorial Hospital. The Southern Pacific doctor, attending him, advises me that they fear complications, and he will be unable to attend the trial today. I ask that the case either remain open for

the further taking of his testimony at a later time during this calendar or that the court grant permission to take a deposition of Mr. Betts in Phoenix, to be made a part of this record. [80]

He came to California for the purpose of testifying and broke his collar bone on the train on the way over.

The Court: What does counsel for the respondent say?

Mr. Crouter: In that respect my only observation is that I want to cooperate with the court and counsel and secure this man's testimony, if they deem it is essential.

I point out we have the written regulations of the Insurance Department. As I understand he was then and perhaps still is connected with the Insurance Department.

As to the question of taking the deposition at Phoenix, the amount of deficiency is the sum of \$734.53. That is for one year. And there is another year. The total amount is \$1,822.12. While that is not determinative of what action respondent or the court would take in securing evidence, I am wondering whether we couldn't make arrangements to have Mr. Betts testify sometime during this week, if he is able, or take his deposition while he is still in the city.

Mr. Cox: Your Honor, that was my idea. The only thing is if the doctors should deem it necessary for him to be returned home by plane directly from the hospital it would place the petitioner in



a bad position. The petitioner has stated before he will vow to the court Mr. Betts anticipated to testify as he testified on previous cases, that not only was this reserve required but that the approval of the policies was required by order, and that no policy would be approved unless that policy had in it a portion for placing in the mortuary reserve fund at least 50 percent of the premium income after the first year. All policies submitted for approval [81] were submitted by the Corporation Commission of Arizona to actuaries and the actuaries reported to the Commission that the reserves set up in the policies were sufficient to meet the requirements of the American experience table of mortality, plus a  $3\frac{1}{2}$  percent accretion or approximation thereof.

Mr. Betts is Chairman of the Arizona Corporation Commission, under which the Insurance Department operates, and we feel that testimony having been given before would not be varied at this time.

The Court: Counsel for the respondent wants the right to cross examine the witness, or could you gentlemen stipulate along that line if it is true that that would be his testimony?

Mr. Crouter: No. The prior testimony related to other years and did not purport to relate to 1939 and 1940 at all. Now, counsel has agreed with me in that respect prior to now.

Mr. Cox: Yes.

Mr. Crouter: He has agreed there is nothing in

his prior testimony that relates to these years. It may have been the practice and procedure of that office, but we have nothing in that prior testimony or anywhere else, that I know of, even in affidavit form, as to exactly what the position and requirement of the Insurance Commissioner was.

We also have this position. It is a matter of fact, as established by the State Supreme Court decision we referred to yesterday, that some insurance companies in that State did not comply with the rules and regulations of that Insurance Commissioner. Now, whether this company did comply has never been thoroughly gone into, as far as I know, as for these [82] years. I don't want to take any advantage here. I don't want to do anything that will make it difficult either for the witness or counsel, but it would seem to me that with that witness already in the city, with the court sitting here and even after the court departs, if it is convenient to take a deposition, then it could be added to this record. I would like to do it while he is here. It wouldn't take very long. It would just save the necessity of an attorney from this office dropping other things and going to Phoenix.

Mr. Cox: Of course, I am willing to come back, if the court so desires, from Phoenix for the purpose of taking the deposition or to make arrangements here. It would seem that a man of that position, and the records will certainly show, I thought that counsel could get together and go to the White Memorial Hospital and stipulate on his testimony, after talking to Mr. Betts.

The Court: We will suspend with this case then until I hear from you gentlemen.

(Thereupon, a recess was taken for three hours, forty-five minutes, at the conclusion of which, the following occurred:)

Mr. Cox: May it please the court, may I state a stipulation concerning the case we had under discussion this morning?

The Court: Yes.

Mr. Cox: The petitioner stipulates that the statement of Amos A. Betts, the transcript will be furnished by Mr. Crouter, and will be received with the same force and effect as a deposition of Mr. Betts, unsigned in any manner, but just as presented by Mr. Crouter tomorrow. [83]

Mr. Crouter: That is agreed upon, and agreeable to the respondent. I may, however, say we have arranged to Mr. Cox will have a copy of that and it will be an agreed and accurate statement of the testimony which has been taken of the witness today.

The Court: That concludes that case?

Mr. Cox: That concludes that case.

Mr. Crouter: That is correct.

(Hearing concluded.)



\* \* \* \*

The foregoing is the substance of all the material evidence, oral and documentary, adduced at the trial of the proceeding by The Tax Court of the United States, which is pertinent to the issues on review of the rulings and decision of the Tax Court assigned as error by the Commissioner of Internal Revenue in his statement of points.

/s/ DOUGLAS W. MCGREGOR

CAR

Assistant Attorney General.

/s/ J. P. WENCHEL

Chief Counsel, Bureau of Internal Revenue, Counsel for Commissioner.

#### STATEMENT OF SERVICE:

A copy of Statement of Evidence was mailed to Z. Simpson Cox, Esq., 406 Phoenix National Bank Bldg., Phoenix, Arizona, this 2nd day of August, 1946.

/s/ JOHN W. SMITH

Special Attorney,

Bureau of Internal Revenue.

[Endorsed]: T.C.U.S. Received and Filed Aug. 2, 1946. [84]

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#### PETITIONER'S EXHIBIT No. 1.

[Printer's Note]: Par. 11 of General Provisions appended to specimen "Individual or Group Life

Policy," included in Petitioner's Original Exhibit 1, reads:

11. Reserve or Mortality Fund—After the first month 25% of the first year's premium and  $66\frac{2}{3}\%$  of all subsequent payments, will be placed in this Fund, for the purpose of payment of claims and expenses incidental thereto.

---

[Printer's Note]: Par. 11 of General Provisions appended to specimen "Whole Life Ins. Policy," included in Petitioner's Original Exhibit 1, reads:

11. Reserve or Mortality Fund—After the first month (50%) of each payment of the first year's Premium and ( $66\frac{2}{3}\%$ ) of all subsequent payments will be placed in this Fund, for the purpose of claims and expenses incidental thereto.

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[Printer's Note]: Par. 15 of General Provisions appended to specimen "Family Group Union Association," (Whole family protection policy), included in Petitioner's Original Exhibit 1, reads:

15. Reserve or Mortality Fund—After the first month (50%) of each payment of the first year's Premium and ( $66\frac{2}{3}\%$ ) of all subsequent payments, will be placed in this Fund, for the purpose of payment of claims and expenses incidental thereto.

[Printer's Note]: Par. 15 of General Provisions appended to specimen "Family Group Union Association," (individual protection policy), included in Petitioner's Original Exhibit 1, reads:

15. Reserve and Mortality Fund—After the first month (50%) of each payment of the first year's Premium and (66-2/3%) of all subsequent payments, will be placed in this Fund, for the purpose of payment of claims and expenses incidental thereto.

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[Printer's Note]: Par. 15 of the General Provisions appended to specimen "Family Group Union Association," (individual protection certificate), included in Petitioner's Original Exhibit 1, reads:

15. Reserve or Mortality Fund—After the first month (50%) of each payment of the first year's assessment and (66-2/3%) of all subsequent payments, will be placed in this Fund, for the purpose of payment of claims and expenses incidental thereto.

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## PETITIONER'S EXHIBIT No. 2.

### Articles of Incorporation of

### National Reserve Insurance Company

Know All Men By These Presents: That we, the undersigned, have this day voluntarily associ-



ated ourselves together for the purpose of organizing and incorporating a National Reserve Insurance Company under the laws of the State of Arizona. And We Hereby Certify:

First: That the name of said corporation shall be National Reserve Insurance Company.

Second: That the purposes for which said corporation is formed are: to engage in, conduct and carry on the business of a National Reserve Insurance Company within the meaning of the provisions of Paragraphs 607, 608, 609, 610, Chapter 14, Article 3, Revised Code of Arizona, 1928, as the same now exists or may hereafter be amended; and generally to do all and everything necessary, suitable, convenient and proper for the accomplishment of the purposes above mentioned, or the attainment of any one or more of the objects hereinbefore named, or which shall at any time appear conducive to, or expedient for the protection or benefit of the corporation and the interests of the members and their beneficiaries.

Third: That the principal place of business of said corporation shall be Phoenix, Arizona, but offices may be established, business transacted and meetings of members and directors [100] held at such places within or outside of Arizona as the by-laws shall provide.

Fourth: The term for which said association is to exist is twenty-five years from and after the date of its incorporation but this association shall have the right and reserves the right to renew or

continue its term of existence from time to time in accordance with the provisions of the laws of Arizona, in that respect.

Fifth: The affairs of this association shall be conducted by a board of directors consisting of not less than three nor more than fifteen directors who shall be chosen from among the members of this association; except that the first board of directors shall be as hereinafter designated. The board of directors of this association shall have the right to adopt by-laws, rules and regulations governing the affairs and operation of this association and its officers and agents; to adopt any and all amendments to such by-laws, rules and regulations; to designate, appoint and fix the compensation of any and all officers, agents, employees and representatives of this association and to designate their authority and duties; to designate, from time to time, the nature and kind of benefits to be paid to and enjoyed by the members of this association and their respective beneficiaries under membership certificates or other instruments pertaining to such memberships, [101] and to designate all rights and obligations of members and in general, regulate and conduct the affairs of this association and to appoint and elect from among the members of the board, a president, one or more vice-presidents, a treasurer and a secretary and such other officers or agents from among the members of the association, including one or more assistant secretaries, as they shall deem necessary or proper. The board shall have such additional powers and rights as

may be conferred upon them by law and/or the by-laws of this association.

Sixth: The association is organized and formed for the purpose above recited and for the protection of its members and their beneficiaries. It shall not have a capital stock and all the activities of the association shall be carried on by it at the expense of and for the benefit of its members and their beneficiaries on the mutual assessment plan provided in and contemplated by the provisions of said Paragraphs 607, 608, 609, and 610, Chapter 14, Article 3, Revised Code of Arizona, 1928.

Seventh: The voting power, property rights and interest of its members shall be equal, dependent upon the nature and kind or class of membership and membership rights held by such member as evidenced by the nature and kind of membership certificate issued to him or her. The association shall have power to admit members who shall be entitled to vote and contribute to, and share in the property of the association and be subject to such obligations and other rights, in accordance [102] with the nature of the membership certificates issued to them respectively, and as provided in the by-laws.

Eighth: The membership certificate issued to a member for such membership, shall not be assignable or transferable, except that the beneficiary named in any membership certificate may be changed from time to time as provided by the by-laws.



Ninth: The names of the directors selected to hold office for the first three months after the incorporation of this association, and until their successors are elected, are as follows; A. H. Horowitz, Phoenix, Arizona; Joseph Meid, Phoenix, Arizona, Ruth Horowitz, Phoenix, Arizona, who were elected on the 24th day of May, 1934, at Phoenix, Arizona.

Tenth: The directors, officers and members of this association and their private property shall be forever exempt from any liability for or in respect to any debts or obligations of the association.

Eleventh: This association does hereby designate Joseph Meid, of Phoenix, Arizona, as its resident agent under the laws of the State of Arizona, upon whom any and all process in any action, suit or proceeding against this association, may be served.

In Witness Whereof: we hereto affix our signatures this 24th day of May, 1934.

A. H. HOROWITZ

JOSEPH MEID

RUTH HOROWITZ [103]

State of Arizona,  
County of Maricopa—ss.

Before me, Francis P. Wirer, a Notary Public, in and for the County and State aforesaid, on this day personally appeared A. H. Horowitz, Joseph Meid, and Ruth Horowitz, known to me to be the same persons who signed the foregoing instrument,

and acknowledged to me that they executed the same for the uses and purposes therein mentioned.

Given under my hand and seal of office this 24th day of May, 1934.

My commission expires February 27, 1938.

[Seal]

FRANCIS P. WIRER

Notary Public.

### ENDORSEMENT

Arizona Corporation Commission Incorporating Division, Filed May 24, 1934, at 4:30 p.m., at request of Joseph Meid whose address is: 323 Heard Bldg., Phoenix, Arizona.

M. C. HANKINS

Secretary.

By A. O. JONES [104]

### PETITIONER'S EXHIBIT No. 3.

[Printer's Note]: Articles II, III, VII (sec. 5), XV, XVI, XVII (sec. 5) and XVIII of Petitioner's Exhibit 3—By-Laws, reads:

By-Laws

of the

National Reserve Insurance Company

\* \* \* \*

### Article II.

### Office & Place

The principal place of business of this Association and its general office shall be in the City of

Phoenix, State of Arizona; branch offices may be established at any other place or places, where the business of the organization may require an office and the Association may transact business in the State of Arizona and in such other States as the Board of Directors may determine.

### Article III.

#### Purpose

The purpose of this Association is to provide and maintain a Beneficial and Co-operative Benefit Association for the protection of its members, and at the same time create a fund from the savings in the Death Benefit Fund, with which to qualify a legal reserve life insurance company. [105]

\* \* \* \*

### Article VII.

#### Power of Directors

\* \* \* \*

Section 5. The fees and assessments and all other revenues, income or funds of the Association, from whatever sources derived, shall under and by direction of the Board of Directors, be used to discharge any of the obligations of the Association, irrespective of the dates when such obligations were incurred.

\* \* \* \*

### Article XV.

#### Membership

Section 1. All applications for membership shall



be in writing and signed by the applicant, except when a minor, in which event the application shall bear the signature of the applicant's parent or guardian.

Section 2. Every application for membership in this Association shall be on such form as the Board of Directors may prescribe and shall set forth over the applicant's signature his or her name, place of resident and such other information as may be required in the application.

Section 3. No application shall be accepted by the Association without the approval of the Board of Directors or the approval of such other person or persons as may be designated by said Board.

Section 4. The fees for membership in the Association shall be of such amounts as are determined by the Board of Directors.

Section 5. Upon acceptance of the application of any person for membership there shall be issued to him or her a membership certificate setting forth the amount of dues and assessments and the amount of benefits payable, which certificate shall be signed by the President and the Secretary. [112]

Section 6. The Board of Directors may issue certificates of membership requiring such dues and assessments and containing such provisions and conditions as in its judgment may seem best for the interest of the Association.

Section 7. All members of this Association shall be entitled to one vote each, in person or by proxy,

at all membership meetings whether regular or called, and that fifty per cent of all members shall constitute a quorum at any such meeting.

Section 8. All assessments shall be paid to the Association at its home office in Phoenix, Arizona, or to such persons as may be designated in writing by the Secretary of the Association. Failure on the part of any member to pay assessments as provided in the certificate of membership shall lapse the membership and void the certificate.

Section 9. Any member who has lapsed his or her certificate of membership may, within one year from date of lapse, make application for reinstatement of such certificate of membership by paying the current month's payment and furnishing to the Association at its home office, evidence of good health and insurability of all the members of the Certificate holder's family included in the certificate.

Section 10. A member may withdraw from membership in the Association by letting any assessment levied upon him go unpaid for more than ten days from the date the assessment is due and payable or by notifying the Association of such intention of withdrawal, without any further liability ever being imposed upon [113] him through such membership having been held.

Section 11. Every member of the Association shall have the right to change his or her beneficiary or beneficiaries by making request in writing to the Association and designating name or names and

address or addresses of the new beneficiary or beneficiaries, which change shall become effective when approved by the Association at its home office.

## ARTICLE XVI.

### Funds.

Section 1. The Death Benefit Fund of this Association shall be created, maintained and shall consist of Fifty per cent (50%) of the first year's assessment, less the first month's payment; and sixty-six and two-thirds per cent ( $66\frac{2}{3}\%$ ) of all subsequent payments except where a certificate shall lapse and reinstatement shall be dispersed in the same manner as the first year's assessment following the date of issuance of the certificate. The money in the Death Benefit Fund shall be used for the payment of death losses, however, the Board of Directors may set aside a portion of the savings in said fund for the purpose of organizing a legal reserve life insurance company, and shall issue in January of every year beginning January 1936 a certificate of evidence to each member of the Association who has paid twelve consecutive monthly payments without lapsing, showing his or her pro rata in such savings.

Section 2. The expense fund of this Association shall be created, maintained and shall consist of only, the membership and registration fees, the first month's payment of assessment and the first month's payment at time of any reinstatement, and



[114] fifty per cent (50%) of the following eleven month's payment and thirty-three and one third per cent (33-1/3%) of all subsequent payments.

## ARTICLE XVII.

\* \* \* \*

Section 5. No suit in law or equity shall be brought against the Association until ninety days after the death of the member and no suit shall lie against the Association unless begun one year from the date of the death of the member. When there is not sufficient cash in the benefit fund unappropriated from which to pay any death claim then due and payable hereunder, no other action than one to compel the levy of an assessment for the payment of such claim, as herein provided, shall be brought or maintained against the Association. No beneficiary shall have any lien or any claim on any other funds of the Association. [116]

## ARTICLE XVIII.

\* \* \* \*

### Liability of Members.

Section 1. The members of this Association are not and shall not be liable for any debts of this Association or for any other obligations save and except in respect to the payment of the membership fee, dues and assessments. [117]

\* \* \* \*

## PETITIONER'S EXHIBIT No. 5

Arizona Corporation Commission

General Order No. 160-I

In the Name of the State of Arizona:

To all Benefit Corporations licensed to do business in the State of Arizona:

Greetings:

Pursuant to the authority vested in this Commission by the constitution and laws of the State of Arizona.

It Is Ordered: That from and after the date hereof, Benefit Corporations shall cease issuing certificates of insurance containing non-feiture values, such as cash loans, cash surrender values, paid-up insurance or extended insurance.

It Is Further Ordered that part of each premium be placed in the Mortuary Fund, beginning with the second policy year.

It Is Further Ordered that premium due notices be mailed to each policy holder and a notice of each reinstatement be mailed, calling attention to the policy provision that sets us a new equity as a result of such lapse and reinstatement.

It Is Further Ordered that premiums shall be deemed paid within the grace period, if the envelope in which the premium was mailed bears a post mark dated before midnight of the last day of grace, and that envelopes in which premiums are mailed that bear a post mark dated after midnight of the last day of grace, shall be filed to support any defense the company may care to make.

It Is Further Ordered that all solicitors of insurance for Benefit Corporations shall be deemed agents of the Benefit Corporation to which the solicitor submits applications for insurance [124]

It Is Further Ordered that applications for insurance in Benefit Corporations shall contain no policy provisions that are not also contained in the policy, and that application for insurance in Benefit Corporations, other than for family group insurance, shall be signed by the applicant if applicant is not a minor.

It Is Further Ordered that all agents of Benefit Corporations shall have on their persons, at all times, sample policies when soliciting, and shall in each instance offer to let each applicant read the copy of the policy applied for.

It Is Further Ordered that premiums shall be paid by the policy holder, unless the payee is also a policy holder in the same company.

It Is Further Ordered that all benefits shall be referred to in the policy as maximum benefits if the policy or by-laws contain special assessment or prorated clauses, and that the full amount of each special assessment shall be placed to the credit of the Mortuary Fund.

By order of the Arizona Corporation Commission.

WILLIS G. ETHEL,  
Secretary.

Dated at Phoenix, Arizona this 7th day of June, 1939. [125]



## PETITIONER'S EXHIBIT No. 6.

## Arizona Corporation Commission

## General Order No. 165-I

To all Benefit Corporations licensed to transact business in the State of Arizona:

As a matter of sound public policy, all benefit corporations are hereby ordered to issue and deliver to certificate holders checks in payment of all dividends on participating certificates of insurance that are not left with said Benefit Corporations to accumulate or to be added to the face value of the certificates of insurance.

It is also ordered that all Benefit Corporations which declare dividends to holders of participating certificates of insurance, shall declare such dividends with the advice and consent of the Corporation Commission as to the amount of such dividends.

Effective February 16, 1940.

WILLIS G. ETHEL,  
Secretary.

Dated this 13th day of February, 1940. [126]

## RESPONDENT'S EXHIBIT A

## COMPARATIVE BALANCE SHEET

National Reserve Insurance Company

\*\*\*

As of Dec. 31, 1938    As of Dec. 31, 1939

## ASSETS:

Cash on Hand....	34.75	432.68
Mortality Fund		
(Valley Bank)....	5,325.07	4,415.99

## RESPONDENT'S EXHIBIT A (continued)

## COMPARATIVE BALANCE SHEET

National Reserve Insurance Company

\*\*\*

## ASSETS: (continued)

Mortality Fund (First Nat'l Bank)		2,500.00
Stocks and Bonds (Deposited with State) .....	2,025.00	
Bonds .....		5,015.58
Cash (Deposited with State) .....		2,000.00
Notes Receivable	250.00	259.66
Advance to Agents	238.89	254.21
Expense Fund (First Nat'l Bank)	6.21	39.05 (Red)
Clock Account ....	3.81	
Premiums Pending	1.44	
First Federal Savings & Loan Co. (Dividend De- pository) .....	100.00	

## LIABILITIES:

Notes Payable ....		400.00
Reserve for future death claims .....	7,952.34	14,509.99
Reserve for hospi- talization claims ..	143.12	149.58
Accrued Dividends	225.00	
A. S. Gibbons.....	5.00	3.00
Commissions due..	11.72	62.68
Pending and Miscellaneous .....		24.09
Salary Account		
W. W. Franklin	1,295.56	1,359.01
K. K. Pound....	1,358.71	1,358.18
Profit and Loss....	3,006.28 (Red)	3,027.46 (Red)
	<hr/>	<hr/>
	7,985.17	7,985.17 14,839.07 14,839.07 (Red)

[Letterhead of National Reserve Insurance Company]  
[Phoenix, Arizona.]

March 12, 1940

Collector of Internal Revenue

Phoenix

Arizona

Dear Sir:

I am attaching Form 1120 in duplicate, being our Corporation income and excess profits tax return for the calendar year 1939.

The undersigned Company is a non-profit Corporation operating under Arizona House Bill 64, an act relating to benefit corporations and generally referred to as the Benefit Corporation Law of 1937. The income and expense shown in the enclosed return is based upon such membership fees, registration fees, and that portion of renewal premiums which the Corporation is permitted to retain for the payment of agents' commissions and general office operating expense.

Information Forms 1096 have not been submitted as required in Section 9-1 of General Instructions, for the reason that commissions allowed to agents do not come to the Corporation as cash Income, but are retained by the agent as and when paid in the field by the applicant; and we therefore have no control over this situation and no record of what is actually collected. The turnover in agency personnel is so great that it is doubtful that any agent received in excess of \$1,000 if single, or \$2500 if married.

With reference to the item in our balance sheet captioned "Reserve for future death claims," wish to state that the amount shown is the net amount remaining at the end of the year after payment of all claims, and inasmuch as the Corporation has invested no part of this reserve fund for a length of time sufficient to make an earning, it therefore is not an income-determining factor in the enclosed return.

Yours very truly,

NATIONAL RESERVE INSURANCE COMPANY

By: /s/ WM. WAHL,

Assistant Secretary.

WW/dec

[134]



## RESPONDENT'S EXHIBIT C

## NATIONAL RESERVE INSURANCE COMPANY

ANALYSIS OF MORTALITY FUND AS OF  
DECEMBER 31st, 1939

Net Requirement in Reserve Account for Future Death Claims (Excepting Hospitalization) .....	14,509.99	
Net Requirement in Reserve Account for Future Sick and Accident Claims (Hospitalization) .....	149.58	
	<hr/>	
Total Reserve for all Future Claims	14,659.57	
Cash and Other Assets held in reserve for claim purposes:		
Deposited in Valley National Bank....	5,325.07	
Deposited in First National Bank.....	2,500.00	
Cash on Hand .....	432.68	
Cash on Deposit—State of Arizona ....	2,000.00	
Secured Note Receivable—Mitchell ....	285.00	
Secured Note Receivable—Tyler .....	52.16	
Bonds .....	5,015.58	
Surplus in excess of Requirements .....	41.84	
	<hr/>	
	14,701.41	14,701.41
		H-1 [143]

## RESPONDENT'S EXHIBIT D

## MORTUARY FUND

Balance in Reserve January 1, 1939 .....		8,095.46
Gross Amount allocated to Fund, Year 1939 .....	11,990.08	
Paid out for Death Claims 3,828.04		
Paid out refunds to Policy- holders .....	1,597.93	5,425.97
	<hr/>	<hr/>
Balance of 1939 allocation un- expended .....		6,564.11
		<hr/>
Total Reserve Fund December 31st .....		14,659.57
Gross Amount allocated to Fund, 1940 .....	14,514.16	
Paid out for Claims .....	5,437.60	
Paid out Refunds to Policy- holders .....	4,154.18	9,591.78
	<hr/>	<hr/>
Balance 1940 allocation unex- pended .....	4,922.38	
Less allocation to fund on hospitalization in error, based on State Examina- tion, January 14, 1941 ....	241.56	4,680.82
	<hr/>	<hr/>
Total Reserve Fund December 31, 1940 .....		19,340.39
		I-1 [144]

## RESPONDENT'S EXHIBIT E

## NATIONAL RESERVE INSURANCE COMPANY

Analysis of Mortality Fund as of December 31, 1940

Cash on hand in Company's Office	\$ 832.33	
Cash in Banks .....	10,415.93	
Valley National .....	6,586.55	
First National .....	3,829.38	
Deposit State Treas. ....	2,789.47	
Gov. and Municipal Bonds .....	5,015.58	
(Realty) Secured Loans .....	349.92	
	<hr/>	
	19,393.23	
Surplus .....		52.84
		<hr/>
		19,393.23

Above is summary of Mortuary Fund as of December 31, 1940, as taken from minutes of January 25, 1941, and which are as reflected by books of the company.

J-1 [145]





GENERAL LEDGER

SHEET  
NO.

National Reserve Insurance Co.

ACCOUNT  
*Mortality*  
*Funds*

SERVICE LINE FORM 808

STANDARD GENERAL LEDGER

DATE

1938

DEBITS

V

DR.  
OR  
CR.

BALANCE

V

Jan 6 750

Oct 31 \* Balance

31 Error

31

Nov 30 71, 745.50 x

30 \* Hoop

30 Inspe

30 Travel

30 Proport 600

30

Dec 31 Decem 7243.26 x

21 Refund

31 \*

31

31 Death

31 3 fr.

1939

Jan 31 Jan 98654 ✓

31

Feb 28 Feb 7521 ✓

28 Inspe

28 (As of)

28 (As of) 10074 ✓

Mar 31 Mar 1206

31 6 La

31 Refund

NOV 25 1944

PETITIONER'S

EXHIBIT

RESPONDENT'S



## GENERAL LEDGER

SHEET  
NO

ACCOUNT:

Income - Premium Renewals -

National Reserve Insurance Co.

ACCOUNT

Maddox  
Trust

STANDARD GENERAL LEDGER

STANDARD GENERAL LEDGER

DATE

DESCRIPTION

POSTING  
REF

CHARGE

CREDITS

DR.

CR.

CO.

BALANCE

1931

Forward

Oct 31 Adams C.R. Rucker 37<sup>th</sup> Sephan 74 CD11 ✓

31 Error - Represent Commission

31 Error - Represent Commission

Nov 30 To over her

30 Hoop. Claim black Womack

30 Inspection Fee Parist Claim

30 Traveling Expense - Fair Claim 2.06

30 Proportion - Adams (Pay mat Rucker)

30 Proportion - Adams (Pay mat Rucker)

Dec 31 To over her

31 Refund - Proportion Premium Pd 74<sup>th</sup> May 2031 Refund - Adams Premium Refd 20<sup>th</sup> May 2031 Refund - Adams Premium Refd 20<sup>th</sup> May 2031 Refund - Adams Premium Refd 20<sup>th</sup> May 2031 Refund - Adams Premium Refd 20<sup>th</sup> May 20

1932

Jan 31 To over her

31 To over her

Feb 28 To over her

28 To over her

28 To over her

28 To over her

Mar 31 To over her

31 To over her

31 To over her





National Reserve Insurance Co.

UNT  
NO.

ACCOUNT

Income Premium Renewals

Morbidity  
Fund

FORM 802

STANDARD GENERAL LEDGER

DATE	DESCRIPTION	POSTING REF	CHARGES	CREDITS	DR. CR.	BALANCE
31	Forward					
31	Acct 400 Hudson ex 7. #1-3425	3247	88			1051324
30	April	CR 16		89209 ✓		
30	Refund - Annual Premium	CR 26	1500			
30	Refund by State 50% of fee	CR 26	7500			
30	Death claim other cause	CR 26	8100			
30	Cost of check book	CR 26	100			1125323
30	Transfer 2,937 Dow Cost to premium	3250		15001		
30	Dividend 1937 Dow Cost 212	3250	7501			
19	1938 Dividend	3250	159793			
31	May	CR 18		93333 ✓		
31	Acct Chesapeake ex 7. #71-722-723	3247	17001			106423
31	Refund - 15 years claim 1-2047	CR 41	750			
31	1937 Dividend 712	CR 41	750			
31	Death claim North Union	CR 41	10000			1044103
30	June	CR 41		94231 ✓		
31	Acct Edwin Buster Coleman	CR 45	3700			
30	Service Chy by Mark June	CR 56	7101			
30	Transfer from Pandey acct.	CR 23		5091 ✓		1125103
31	July	CR 23		96461 ✓		
31	Death claim - J. S. Weaver #5195	CR 49	30000			
31	Pauline Bryant	CR 49	56			116015
31	Propeller	CR 53	1501			
31	Fred S. McSwain	CR 53	211001			
31	Fred S. McSwain (Refund)	CR 53	5001			
31	June Mae Chambers	CR 53	283501			

CV



GENERAL  
SHEET  
NO.

National Reserve Insurance Co

ACCOUNT NO. *Mortality Fund*

DATE		DITS	DR. OR CR.	BALANCE
19	34			
Aug	31	87244.1		12347.52
Sept	30	ay		
	30	72245.1		
	30			
	30			
	30			
	30			
	30			
	30			
Oct	31	7126.1		121694.1
	31			
	31	79401		13063.42
Nov	30	06041		
	30			
	30			13818.58
Dec	31	01985		
	31	01081		
	31			
	31			14509.99
Jan	31	12156		
	31			15606.55
Feb	29	06184		16668.49
	29			16256.03
Mar	29			
	29			16255.92





## GENERAL LEDGER

SHEET  
NO.

ACCOUNT

Income Premium Payments - *Morrell's Fund*

National Reserve Insurance Co.

ACCOUNT:

*Morrell's Fund*

CHARGES GENERAL LEDGER

STATE OF IOWA FORM 808

DATE	DESCRIPTION	POSTING REF	CHARGES	CREDITS	DR. CR.	BALANCE
18 34						
Aug 31	Aug	9722		9722.41		12347.52
Sept 3	4c N. S. Ck Bldg. - <i>Hand = 3000</i>	9722	13.21			
30	Sept	9722		9722.41		
30	Death Claim - Fred D. M. Lewis	9057	131.00			
30	- Pauline Bryant	9057	2.00			
30	- Alma Chambers	9057	16.50			
30	- Oliver Kennedy	9057	5.00			
30	- Oliver Kennedy	9057	400.00			
30	Transfer from Pending Acct. - <i>Hand</i>	9722		12.10		12169.41
Oct 31	Death Claim - Harrison D. Weston	9060	400.00			
31	- Nellie Forty	9060	200.00			
31	Oct	9722		994.01		13063.42
Nov 30	Nov	9722		1060.41		
30	Death Claim - James Turner	9065	300.00			13818.58
30	- <i>Hand</i>	9722	2.00			
Dec 31	Death Claim - Burns	9067	16.50			
31	- <i>Hand</i>	9067	300.00			14509.99
Jan 31	Jan	9722		1121.56		15631.55
31	Credit By State 50% of fee	9071	25.00			16658.49
Feb 29	Feb	9722		1060.41		16756.03
29	Death Claim - Pauline Bryant	9072	700.00			
Mar 24	Death Claim - Daisy Cline	9072	200.00			
24	Refund Letter from - <i>Hand</i>	9072	12.46			16756.03

K-2



National Reserve Insurance  
GENERAL LEDGER

ACCOUNT

City Fund

Life

FORM 808

GENERAL LEDGER

DESCRIPTION BALANCE

✓

	625593	
Acct Life Crozier	626183	✓
Mar	737912	
Death Claim Dor		
Leif	87972	✓
Refund Samuel	87772	✓
Proportion H Frank	87816	✓
Correction 30 94	87766	
Turner		
Correction Griffith		
Initials		
Platt		
n. G. Ck Walter W		
Death Claim J.C. P		
Inspection Kearn	88790	✓
Death Claim Ma		
1939 Dividend - Partis		
Death Claim Colen		
Gravim Expense - Helle		
Medical Fees Weber 300	402982	
Extra Combs. Up - Julem	01417	
Death Claim - M		
Ar		

11-4





National Reserve Insurance Co.

GENERAL LEDGER

ACCOUNT

Income Premium Renewals

Mortality Fund

SHEET

NO.

Life

STANDARD GENERAL LEDGER

DESCRIPTION	POSTING REF.	CHARGES	CREDITS	DR. CR.	BALANCE
44 Death Hays Crozier	3278		600 ✓	B	167893
31 Mar	28241		111779 ✓		1676193 ✓
3 Death Nelson Dornan	2079	4000 ✓			1737932
31 Leffert	2079	1000 ✓			1687932
31 Richard Samell	2079	400 ✓			1687932
31 Corporation W. Franklin Re	3277		44 ✓	67	1687932
31 Correction 34 994 Davis	3279		134 ✓	67	1687816 ✓
31 Term 451 Han	3279	50 ✓			1687766
31 Correction Leffert 469	28243		113480 ✓		
31 Nichols 4550	3279	69 ✓			
31 Platt 4551	3280	75 ✓			
31 p. 9. Ck. W. L. Leonard	3281	413 ✓			
31 Death Claim J. C. Prescott	2084	466 ✓			
31 Inspection K. L. Lamy	2084	300 ✓			
31 Death Claim - Manire	2084	7500 ✓			17605 ✓
31 1921 Dividend - Partial 455	2084	162193 ✓			
31 Death Claim Coleman & Rensel	2084	10000 ✓			
31 Insurance Expense - Williams & Kiersey Claim	2084	20000 ✓			
31 Medical Fee 300 - Jackson 300	2084	1200 ✓			1702982
31 Death Claim - Up - Jackson 1000 - Threlkeld 1000	2084	1565 ✓			1701417
31 Death Claim - Archie Walker	2084	5000 ✓			
31 Arthur Walker	2084	12000 ✓			

K-4



GENERAL

SHEET  
NO.

*fund*

ACCOUNT  
NO.

SERVICE OF THE

STANDARD GENERAL LEDGER

DATE		EDITS	✓	DR. OR CR.	BALANCE	✓
1940						
<i>June</i> 30		<i>Dr</i>				
30		<i>Dr</i>				
30		<i>Dr</i>				
30		<i>Dr</i>				
30		<i>Dr</i>		120		
30		<i>Dr</i>		2193		
<i>July</i> 31		<i>Dr</i>		2253	17118 85	
31		<i>Dr</i>				
31		<i>Dr</i>				
31		<i>Dr</i>				
31		<i>Dr</i>				
31		<i>Dr</i>				
31		<i>Dr</i>				
31		<i>Dr</i>				
31		<i>Dr</i>				
31		<i>Dr</i>				
31		<i>Dr</i>				
31		<i>Dr</i>				
31		<i>Dr</i>				
<i>Aug</i> 31		<i>Dr</i>			17253 51	
31		<i>Dr</i>				
31		<i>Dr</i>				
31		<i>Dr</i>				
31		<i>Dr</i>				
31		<i>Dr</i>				
31		<i>Dr</i>			16383 76	
<i>Sept</i> 30		<i>Dr</i>				
31		<i>Dr</i>				
31		<i>Dr</i>				
31		<i>Dr</i>				
31		<i>Dr</i>				
<i>Nov</i> 30		<i>Dr</i>				
30		<i>Dr</i>				





## GENERAL LEDGER

SHEET  
NO.

ACCOUNT

Reserve for Mortuary Fund

ACCOUNT  
NO.

DATE	DESCRIPTION	POSTING REF.	CHARGES	CREDITS	BAL. CR.	BALANCE
June 30	Forward					
30	Death Plain J. Burt	CR 94	25.00			
30	Services Chy Burt	CR 94	2.99			
30	Balance 1939 Dist. Declaration	CR 94	4.29			
30	Adj. #4775 Ramsey	CR 55		1.20		
30	See Journal	CR 56		2.93		17.18 85
July 31	Fun. Income	CR 99		1.22	53	
31	Following from Umbrian	CR 99	5.00			
31	Death Plain Munkley	CR 99	500.00			
31	Following from Jackson Plain	CR 99	2.50			
31	Medical Inspection Death Plain	CR 99	240.00			
31	Death Plain Portland	CR 99	100.00			
31	Death Plain Jackson	CR 99	420.00			
31	Services Chy Burt	CR 99	7.48			
31	Washington Adj.	CR 99		1.11		17.23 57
Aug 31	Fun. Income	CR 25		1.25	05	
31	Following Jackson	CR 94	6.40			
31	Services Chy Burt	CR 100	7.63			
31	1939 Dividend	CR 10	210.95			
31	Adj. Burch Dec Journal	CR 59	1.25			16.38 76
Sept 30	Income Sept.	CR 25		1.11	44	
Oct 31	Oct	CR 55		1.25	47	
31	Death Plain - Kincaid	CR 114	25.00			
31	Income - Nov Ramsey	CR 114	100.00			
Nov 30	Income - Nov	CR 114		1.20	114	
30	Death Plain Burt	CR 114	25.00			
Dec 31	Expense Kincaid Death Plain	CR 114	2.50			



GENERAL LEDGER

NT

NO.

ACCOUNT

Reserve for Mortuary Fund

SHEET  
NO.

GENERAL LEDGER

DESCRIPTION	POSTING REF.	CHARGES	Y	CREDITS	Y	DR. CR. DR.	BALANCE	Y
Death Claim Harbrough	20119	2500						
" " Goble	20119	2500					1950397	
" " Mercantile Expense	20120	2500						
Death Claim Gibbons	20125	1000.00						
" " Howe	20125	1000.00						
" " Adams	20125	2000.00						
" " County STATE AUDITOR	20125	125.00					1924079	
Ref. Journal	20107			1874				
" "	20109			620				
" "	20110			272				
" "	20111			118				
" "	20111			167				
" "	20111			167			1927297	
Death Claim Burke	20134	2500						
" " Burke Expense	20135	495						
" " Burke	20141	310					1900987	
1940 Refund Thompson 1 Per Detail	20146	507.65	✓				1850202	
1940 " " No. 1	20151	519.27	✓				1798275	
1940 " " No. 3	20156	267.00	✓				1771585	
1940 " " No. 4	20161	230.66	✓				1668489	
1940 " " No. 5	20171	675.96	✓				1600893	
Attorney Fees - Brief. Federal Bureau of Investigation	20177	135.15	✓				1587378	
1940 Refund Bureau of Post Office	20177	430	✓				1566898	
1940 Refund Bureau of Post Office for detail	20184	600.37	✓				1526851	





## STATEMENT BY AMOS A. BETTS

It is agreed that this is a statement of Amos A. Betts, Chairman of the Corporation Commission of Arizona, taken at the White Memorial Hospital, Los Angeles, California, on November 28, 1944, elicited by questions from Z. Simpson Cox, attorney for petitioner, the respondent being represented by Earl C. Crouter, and that said statement shall be received in evidence in the proceeding of National Reserve Insurance Company v. Commissioner, Docket No. 112638, with the same force and effect as a deposition.

Mr. Cox: Mr. Betts, after June 12, 1937, the effective date of the Benefit Corporation Law of Arizona of 1937, did the Commission require presentation of a representative policy on each form to be issued by National Reserve Insurance Company?

Mr. Betts: Yes. Every policy that one of the companies issued must be submitted to the Commission. That has been the policy ever since that law was enacted, and we in turn send it to our actuary in Denver to pass upon as to whether or not it will meet all of the requirements of the law and of our rules and regulations with relation to the reserve fund that is set up for the protection of the policy holders. After the first year that form must never be less than 50% and some of them are more than that. We are advised by our actuary that this fund protects the reserve fund to meet all the requirements of the American Standard Mortality on the basis of 31½%.

Mr. Cox: The National Reserve Insurance Company has been examined every year since that time?

Mr. Betts: Yes.

Mr. Cox: So far as your know, has that company lived up to the requirements of the Corporation Commission?

Mr. Betts: It has. Yes. [152]

Mr. Cox: There was some question raised about some of the companies having trouble with the Commission in not setting aside sufficient funds or questioning the authority of the Commission. Has the Commission ever had any trouble of that nature with National Reserve?

Mr. Betts: None whatever.

Mr. Crouter: Mr. Betts, with respect to any mortality reserve, what specifically was the regulation, if any, as to the use of such a reserve for payment of claims?

Mr. Betts: That reserve can be used for no other purpose except to pay claims and to pay the cost incident to litigation in which a claim may be contested. Absolutely no other manner of expenditure of that fund is permitted.

Mr. Crouter: Was such a fund required to be kept at any particular place or in any particular manner?

Mr. Betts: I don't know that I understand.

Mr. Crouter: I mean in any particular banks or anything of that sort.

Mr. Betts: No, but in connection with the annual examinations of these companies the bank accounts are examined, inspected, to see that they

check with the reports of the companies with respect to not only that fund, but all other funds that they have.

Mr. Crouter: Was there any requirement as to any part of any such fund which had to be kept separate and apart and not used for any litigation expenses or other expenses in connection with contests of claims?

Mr. Betts: Well nothing—I don't think—I don't recall that there has ever been any rule with respect to expenses out of that fund other than the payment of death claims. [153]

Mr. Crouter: But there was no limit on the percentage that could be used for cost of litigation as against costs of payment of claims alone?

Mr. Betts: No, that question hasn't been raised. I would say in our examinations if we find a case in which it appears that the cost of litigation is excessive, we would immediately inquire into it and we would have the power, if we found it excessive, to require that the fund be replenished.

Mr. Crouter: Then as I understand it, in 1939 and 1940 there was no law and no regulation of the insurance department that covered that situation?

Mr. Betts: No, that is right. There was no specific rule by us with respect to the amount that might be expended incident to litigation. Is that what you mean?

Mr. Crouter: Yes.

Mr. Betts: We have never had a case come up that appeared to us to be excessive.

Mr. Couter: Mr. Betts, the record shows a regu-



Par. 15 of General Provisions appended to specimen "Family Group Union Association," (individual protection policy), included in Petitioner's Exhibit 1.

Par. 15 of the General Provisions appended to specimen "Family Group Union Association," (individual protection certificate), included in Petitioner's Exhibit 1.

Petitioner's Exhibit 2, Articles of Incorporation.

Articles II, III, VII (sec 5), XV, XVI, XVII (sec. 5) and XVIII of Petitioner's Exhibit 3—By-Laws.

Petitioner's Exhibit 5 — Arizona Corporation Commission General Order No. 160-I, dated June 7, 1939.

Petitioner's Exhibit 6 — Arizona Corporation Commission General Order No. 165-I, dated February 13, 1940.

Comparative balance sheet as of December 31, 1938 and 1939, with letter dated March 12, 1940 of the National Reserve Insurance Company to the Collector of Internal Revenue, Phoenix, Arizona, all attached to Respondent's Exhibit A.

Respondent's Exhibit C, analysis of Mortality Fund as of December 31, 1939.

Respondent's Exhibit D, Mortality Fund, balance in reserve January 1, 1939.

Respondent's Exhibit E, analysis of Mortality Fund as of December 31, 1940.

Respondent's Exhibit F, Mortality Fund balance (General Ledger) October 31, 1938 to December 31, 1940. [156]

Statement by Mr. Amos A. Betts, Chairman of the Corporation Commission of Arizona, as to reserve requirements imposed upon insurance companies by said Commission.

6. Statement of points to be relied upon by the Commissioner.

7. Designation of the record, proceedings, and evidence to be contained in the record on review.

/s/ DOUGLAS W. MCGREGOR,  
Assistant Attorney General.

/s/ J. P. WENCHEL, CAR  
Chief Counsel, Bureau of Internal Revenue Counsel  
for Petitioner on Review.

Statement of Service:

A copy of Petitioner's Designation of the Portion of the Record to be Printed was mailed to Z. Simpson Cox, Esq., 406 Phoenix National Bank Bldg., Phoenix, Arizona, counsel for respondent on review this 2nd day of August, 1946.

/s/ JOHN W. SMITH,  
Special Attorney,  
Bureau of Internal Revenue.

JWS:RRZ 7-30-46

[Endorsed]: T.C. U.S. Received and filed Aug. 2, 1946. [157]

## Statement of Service:

A copy of Designation of Portions of Record, Proceeding and Evidence to be contained in the Record on Review was mailed to Z. Simpson Cox, Esq., 406 Phoenix National Bank Bldg., Phoenix, Arizona, counsel for respondent on review this 2nd day of August, 1946.

/s/ JOHN W. SMITH,

Special Attorney,

Bureau of Internal Revenue.

JWS:RRZ 7-30-46

[Endorsed]: T.C. U.S. Received Aug. 2, 1946.

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The Tax Court of the United States  
Washington

Docket No. 112638

COMMISSIONER OF INTERNAL REVENUE,  
Petitioner,

vs.

NATIONAL RESERVE INSURANCE COM-  
PANY,

Respondent.

CERTIFICATE

I, Victor S. Mersch, clerk of The Tax Court of the United States do hereby certify that the foregoing pages, 1 to 159, inclusive, contain and are a true copy of the transcript of record, paper and proceedings on file and of record in my office as called

for by the Praeipie in the appeal (or appeals) as above numbered and entitled.

In testimony whereof, I hereunto set my hand and affix the seal of The Tax Court of the United States, at Washington, in the District of Columbia, this 27th day of August, 1946.

[Seal]    /s/ VICTOR S. MERSCH,  
Clerk, The Tax Court of the United States.    E.M.T.

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[Endorsed]: No. 11417. United Stated Circuit Court of Appeals for the Ninth Circuit. Commissioner of Internal Revenue, Petitioner, vs. National Reserve Insurance Company, Respondent. Transcript of the Record. Upon Petition to Review a Decision of The Tax Court of the United States.

Filed August 31, 1946.

      /s/ PAUL P. O'BRIEN,  
Clerk of the United States Circuit Court of Appeals  
for the Ninth Circuit.



